

Audit

Report



OFFICE OF THE INSPECTOR GENERAL

**INTERNAL CONTROLS AND COMPLIANCE WITH
LAWS AND REGULATIONS FOR THE NATIONAL
DEFENSE STOCKPILE TRANSACTION FUND
FINANCIAL STATEMENTS FOR FY 1995**

Report No. 96-190

June 28, 1996

Department of Defense

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Acronyms

CFO	Chief Financial Officer
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DNSC	Defense National Stockpile Center
FAR	Federal Acquisition Regulation
FMR	DoD Financial Management Regulation
JFMIP	Joint Financial Management Improvement Program
MIF	Master Inventory File
OMB	Office of Management and Budget
OSR	Outbound Storage Report



**INSPECTOR GENERAL
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June 28, 1996

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY**

**SUBJECT: Audit Report on Internal Controls and Compliance with Laws and
Regulations for the National Defense Stockpile Transaction Fund Financial
Statements for FY 1995 (Report No. 96-190)**

We are providing this report for your information and use. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits for this fund. Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General, DoD, to render an opinion on the fairness of the presentation of the financial statements and report on the adequacy of internal controls and compliance with laws and regulations. This report includes separate sections on the internal control structure and compliance with laws and regulations in Part I. Part II of the report provides relevant appendixes for management's use. Management comments on a draft of this report were considered in preparing the final report.

We issued a disclaimer of opinion on the National Defense Stockpile Transaction Fund Financial Statements for FY 1995 on February 29, 1996. The reason for the disclaimer of opinion was that the documentation that supports the inventory account value was not available (Appendix F). We are working with management and the General Accounting Office to resolve this impediment for future audits. The internal control structure was effective in accounting for and managing resources, ensuring compliance with laws and regulations, and providing reasonable assurance that the financial statements were free of material misstatements. We found internal control weaknesses over inventory accountability, debt collection techniques, interest revenue disclosures, and financial statement preparation. However, these weaknesses were not material to the financial statements. Our review of compliance with laws and regulations did not disclose any material noncompliance affecting the financial statements. This report does address reportable noncompliance issues related to the internal control findings and other financial statement disclosure inaccuracies. Details of the reportable conditions are discussed in Part I.

Management comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required. However, we request a copy of the results from the Business Process Review that the Principal Deputy Director, Defense Logistics Agency addressed in response to Recommendation A.1.

We appreciate the courtesies extended to the audit staff. Questions about the audit should be directed to Mr. Raymond D. Kidd, Audit Program Director, at (703) 604-9110 (DSN 664-9110) or Mr. John A. Richards, Audit Project Manager, at (703) 604-9133 (DSN 664-9133). Appendix H lists the planned distribution of this report. The audit team members are listed on the inside back cover.

A handwritten signature in black ink, reading "Robert J. Lieberman". The signature is written in a cursive style with a large, stylized "R" and "L".

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-190
(Project No. 5FH-2022.01)

June 28, 1996

Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an annual audit of revolving funds such as the National Defense Stockpile Transaction Fund. The Chief Financial Officers Act prescribes the responsibility of management and auditors with respect to the financial statements, internal controls, and compliance with laws and regulations. Fund managers are responsible for establishing and maintaining an internal control structure and complying with laws and regulations applicable to that fund. Management is responsible for establishing a comprehensive management control system and monitoring and reporting on the system. The fund manager responsible for this fund is the Comptroller, Defense Logistics Agency. As of September 30, 1995, reported National Defense Stockpile Transaction Fund assets were \$4.3 billion and liabilities were \$77.4 million.

Audit Objectives. The primary audit objective was to determine whether the FY 1995 financial statements were presented fairly in accordance with the other comprehensive basis of accounting described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. In addition, we reviewed the management control program, management's compliance with laws and regulations, and followed up on corrective actions from previous audits. Our review provided a reasonable basis for determining the adequacy of the internal control structure and compliance with laws and regulations as they relate to the financial statements.

Disclaimer of Opinion. We were unable to audit the financial statements and, as a result, issued a disclaimer of opinion on the FY 1995 National Defense Stockpile Transaction Fund Financial Statements on February 29, 1996. The reason for the disclaimer of opinion was that the documentation that supports the inventory account value was not available. See Appendix F for the published financial statements, which includes the disclaimer of opinion.

Internal Controls. The internal control structure was effective in accounting for and managing resources, ensuring compliance with laws and regulations, and providing reasonable assurance that the financial statements are free of material misstatements. None of the accounts affected by management control weaknesses addressed in this report resulted in a material misstatement on the financial statements. Our review would not necessarily disclose all internal control reportable conditions that might also be considered material weaknesses. See Part I.A. for the management control

weaknesses identified and Part II, Appendix A for the management controls assessed. Management could improve the management control program relating to:

- o accounting for the Stockpile Materials account which was overstated by \$29 million on the FY 1995 financial statements (Finding A);

- o collecting \$13.4 million in delinquent accounts receivable and related interest charges (Finding B); and

- o recording and reporting \$1.3 million in interest revenue due to the U.S. Treasury (Finding C).

Compliance with Laws and Regulations. Management generally complied with the selected provision of laws and regulations pertaining to the accuracy of the financial statements. However, the Defense National Stockpile Center was not in compliance with guidance set forth in the DoD 7000.14-R, "DoD Financial Management Regulation," volumes 1 and 4, as it relates to recognizing revenue, using appropriate U.S. Treasury interest receivable accounts, establishing appropriate allowances for uncollectible accounts, and classifying inventory in appropriate categories. Defense National Stockpile Center handling of revenue recognition was also not in compliance with Office of Management Budget Statement of Federal Financial Accounting Standards and Concepts, Number 3, "Accounting for Inventory and Related Property," October 27, 1993. In addition, Defense National Stockpile Center financial statement preparation was not fully in compliance Office of Management Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, and "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," October 20, 1994, (Finding D). Additional regulations that were not complied with as they relate to the internal control weaknesses were addressed in Part I.A. Compliance issues identified during our review did not have a material impact on the financial statements. See Part I.B. for the noncompliance issues identified. With respect to items not tested, nothing came to our attention that caused us to believe management had not complied, in all material respects, with those provisions previously identified.

Summary of Recommendations. We recommend the Director, Defense Logistics Agency strengthen procedures over preparing the financial statements. The Director, Defense Finance and Accounting Service Columbus Center should establish accounts to record interest charges receivable and interest revenue. The Administrator, Defense National Stockpile Center should strengthen internal controls over reconciling inventory records, developing a cut-off date for including transactions in the financial statements, and classifying stockpile material categories; attempt to collect the \$12.2 million in delinquent accounts receivable and \$1.2 million in delinquent interest charges; establish standard debt collection procedures; and properly disclose interest revenue due to the U.S. Treasury. In addition, the Administrator, Defense National Stockpile Center, in coordination with the Director, Defense Finance and Accounting Service Columbus Center, should implement procedures to ensure that all corrections made after the end of the fiscal year are included in the related financial statements.

Management Comments. The Deputy Chief Financial Officer recommended adding to the Executive Summary and Part I of the report the reason as to why the disclaimer of opinion was issued on the financial statements. The concern was that having the

reason addressed only in Appendix F could lead the reader to mistakingly conclude that the disclaimer was caused by the issues addressed in this report. The Principal Deputy Director, Defense Logistics Agency stated that a Business Process Review team will be established to determine how to improve existing reconciliation and inventory procedures. In addition, management agreed to: ensure that all corrections made after fiscal yearend are included in the financial statements; establish a task force to review all delinquent accounts receivable; develop standard operating procedures for monitoring and collecting delinquent accounts receivable and interest charges; assign primary responsibility for pursuit of collecting delinquent accounts receivable and related charges; forward all debts greater than \$600 to the Defense Finance and Accounting Service (DFAS); implement the Standard General Ledger and make proper disclosure of interest revenue; properly train personnel in the preparation of financial statements; and review and reconcile financial statements prior to submission. The Deputy Director for Accounting, Defense Finance and Accounting Service stated DFAS Columbus Center will coordinate with Defense National Stockpile Center personnel on implementing procedures to ensure all corrections made after the end-of-year trial balance are included in the financial statements and will provide assistance and guidance in the preparation of financial statements. In addition, DFAS Columbus Center will establish appropriate accounts to record interest charges receivable and the interest collected and deposited into the U.S. Treasury. See Part I for discussion of management comments, and Part III for complete text of management comments.

Audit Response. We revised our report to include the additional references to the disclaimer of opinion. Management comments were responsive to the recommendations. However, we request a copy of the results from the Business Process Review that the Principal Deputy Director, Defense Logistics Agency addressed in response to Recommendation A.1.

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Part I - Audit Results

Audit Results

Audit Background

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires annual audits of funds such as the National Defense Stockpile Transaction Fund (the Fund). Our responsibility under the CFO Act is to express an opinion on the Fund's FY 1995 financial statements based on our audit, determine whether internal controls are adequate and whether the Fund complied with applicable laws and regulations. For background information on the audited entity, see Part II, Appendix F which includes an Overview of the Principal Statements.

Disclaimer of Opinion. We attempted to audit the FY 1995 Financial Statements for the National Defense Stockpile Transaction Fund. The financial statements included the Statement of Financial Position and the Statement of Operations and Changes in Net Position. Also included are the Footnotes and the Overview to the Principal Statements. We issued a disclaimer of opinion on the financial statements on February 29, 1996. The reason for the disclaimer of opinion was that the documentation that supports the inventory account value was not available. Our opinion letter was included in the published financial statements transmitted by the Under Secretary of Defense (Comptroller) to the Office of Management and Budget (OMB). See Appendix F for the financial statements and audit opinion.

Change in Accounting Functions. In June 1994, the Fund accounting functions performed by Defense Finance and Accounting Service (DFAS) located at Cameron Station, Virginia, were consolidated into the DFAS Columbus Center. Currently the Defense National Stockpile Center (DNSC) and the DFAS Columbus Center jointly perform finance and accounting functions for the Fund. A Concept of Operations Agreement, dated July 16, 1994, and amended in FY 1996, specifies each entity's financial and accounting responsibilities. The amended Concept of Operations had no effect on our audit results. As of September 30, 1995, the Fund reported assets of \$4.3 billion and liabilities of \$77.4 million.

Audit Objectives

The primary audit objective was to determine whether the FY 1995 financial statements for the Fund were presented fairly in accordance with the other comprehensive basis of accounting described in the OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993.

In addition, we reviewed the management control program and compliance with laws and regulations, and followed up on corrective actions taken resulting from previous audits of the Fund's financial statements. Part I.A. contains our report on internal controls. Part I.B. contains our report on compliance with laws and regulations. Part II, Appendix A, provides discussion on the scope, methodology, auditing standards, accounting principles and management control program. Appendix B provides a summary of prior audit coverage.

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Part I.A. - Review of Internal Control Structure

Introduction

Audit Responsibilities. Our audit objective was to determine whether controls over transactions supporting the accounts in the FY 1995 financial statements were adequate to provide reasonable assurance that the accounts were free of material misstatements. In planning and performing our audit of the Fund for the fiscal year ended September 30, 1995, we evaluated the internal control structure, including implementation of the DoD Management Control Program. The purposes of this evaluation were to:

- o determine our auditing procedures for expressing an opinion on the financial statements; and

- o determine whether an internal control structure had been established.

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, implements title 31, United States Code, section 3512 (31 U.S.C. 3512), which requires management to establish and maintain a comprehensive management control system, including an internal control structure, and monitor and report on the system. The internal control structure consists of three elements.

- o Control Environment is the collective effort of various factors on establishing, enhancing, or mitigating the effectiveness of specific policies and procedures.

- o Accounting and related systems are those methods and records established to identify, assemble, analyze, classify, record, and report on the entity's transactions and to maintain accountability for the related assets and liabilities.

- o Control procedures are the policies and procedures in addition to the control environment and accounting and related systems which management has established to provide reasonable assurance that specific entity objectives will be achieved.

Management Responsibilities. Management of the Fund is responsible for establishing and maintaining the internal control structure. That responsibility requires management to make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that:

- o transactions are properly recorded and accounted for in order to prepare reliable financial statements and to maintain accountability over assets;

- o funds, property, and other assets are safeguarded against waste, loss, unauthorized use, and misappropriation; and

o transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and in compliance with any other laws and regulations that the OMB, entity management, or the Inspector General, DoD, have identified as being significant for which compliance can be objectively measured and evaluated.

Reportable Conditions

Our review of internal controls for the Fund identified conditions that we considered to be reportable under OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. However, the audit did not disclose any material weaknesses. Reportable conditions are matters coming to the auditors' attention relating to significant deficiencies in the design or operation of the internal control structure that, in their judgment, could adversely affect the organization's ability to effectively control and manage its resources and ensure reliable and accurate financial information for use in managing and evaluating operational performance. A material weakness is a reportable condition in which the design or operation of the internal control structure does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors or irregularities would be in amounts that would be material to the statements being audited and not be detected within a timely period by employees in the normal course of performing their functions.

Although our review of internal controls for the Fund did not disclose any material weaknesses, we noted internal control reportable conditions that management should address to improve reconciling the Master Inventory File to on-site records, recording and reporting stockpile material transactions, collecting accounts receivable and interest revenue, and reporting interest revenue due to the U.S. Treasury. See Part II, Appendix A, for management controls assessed.

Finding A. Accuracy of Financial Statements Stockpile Materials Account Balance

The Stockpile Materials account balance shown on the FY 1995 financial statements was overstated by \$29 million. Specifically, the Master Inventory File (MIF), which supported the inventory balances reported in the financial statements, did not accurately show on-hand quantities, 59 Outbound Storage Reports (OSRs) were not posted to the MIF, overstating the account balance by \$41 million, and stockpile materials sold but not shipped were inaccurately accounted for, understating the account balance by \$12 million. These conditions occurred because DNSC did not have effective procedures for reconciling the MIF with the on-site records, and MIF data was not regularly available to depot personnel. In addition, management had not established a cut-off date for processing all OSRs prior to the end of the fiscal year and a lack of coordination existed between the DNSC and the DFAS Columbus Center when corrections were made after the fiscal year end. Without effective reconciliation procedures, the Stockpile Materials account could become misstated by a material amount in future years and decisions could be made to sell materials based on inaccurate data.

Reconciling of the MIF

Master Inventory File. The MIF is the DNSC official inventory record and is maintained by the Systems Support and Inventory Accountability Division (Systems Division) at DNSC. The MIF is used as the source for the Stockpile Materials account balance shown on the Fund's trial balance maintained by DFAS Columbus Center, and subsequently, the FY 1995 financial statements. The DNSC systems personnel maintained the MIF data base that contained summary line items for on-hand inventory, as well as supplemental tables with stockpile materials in special categories. The summary line items did not provide a history of the transactions that led to the current balance, but contained the current balance, the date of the last transaction, and the last posting document reference number. Receiving and shipping reports, received from depot personnel, were used as the source documentation for changes to the MIF. These documents provided the current balance of the commodity being received or shipped.

Inventory Record Cards. The on-site inventory records, maintained at stockpile materials storage locations, primarily consisted of manual or

Finding A. Accuracy of Financial Statements Stockpile Materials Account Balance

automated Defense Logistics Agency (DLA) Inventory Record Cards (Form 46). The cards have been in use since before the MIF was designed and are still relied upon by depot personnel. Depot personnel used the Form 46 cards for maintaining a "running balance" of the inventory. The Form 46 cards displayed the beginning balance and all subsequent transactions which resulted in the current inventory balance. Depot personnel were responsible for recording and reporting inventory changes to DNSC.

Reconciliation Efforts. Since 1992, neither DNSC nor its depots have attempted a comprehensive reconciliation between the MIF and the on-site records. DNSC systems personnel reconciled the MIF with depot inventory records only for commodities that were currently offered for sale. According to the systems personnel, the balances for the other commodities were not reconciled because the Systems Division did not have the time or resources available. Therefore, systems personnel attempted to reconcile the commodities advertised for sale prior to advertising, and again when the depots submitted notices of shipment. Although this was the practice, the audit identified inventory balances maintained at the depots that differed from those in the MIF even for actively sold commodities. For example, the MIF balance for on-hand cobalt at the Scotia Depot showed 86,000 pounds more than the depot records. The depot records indicated that the cobalt was actively being shipped in June and September 1995.

Depot personnel were not reconciling their inventory records to the MIF because they rarely received a MIF listing, did not have access to the MIF via on-line access or were not using the access, and considered the MIF to be inaccurate and unnecessary and chose to rely on their own local records. In one case in which a reconciliation was attempted as a result of our FY 1992 audit, the DNSC Fort Worth Zone Office reconciled the MIF to all Form 46 cards in its depots. A report was prepared and forwarded to DNSC Directorate of Stockpile Operations in 1992. Although the report identified numerous discrepancies found during the reconciliation, it was never provided to the systems personnel and the discrepancies remained unresolved. In addition, although depot quality assurance personnel performed periodic inventories, any noted discrepancies were usually not updated into the MIF because the discrepancies did not meet the percentage-of-change criteria required for adjusting the inventory balances in the MIF. Since the zone offices and depots did not reconcile their inventory records to the MIF in FY 1995, the commodity balances continue to differ and DNSC has misstated the balance of stockpile materials.

During the audit we attempted to reconcile the MIF and the depot Form 46 cards at the zone offices and depots visited. Problems occurred because the MIF listed individual line items while the Form 46 card summarized a particular commodity. To facilitate our reconciliation we totaled the MIF line items by commodity and compared the total to the Form 46 cards. The initial results

Finding A. Accuracy of Financial Statements Stockpile Materials Account Balance

showed 135 (37 percent) out of 356 commodity balances that differed between the MIF and on-site records. We provided DNSC a listing of 83 of these imbalances from our first audit locations to determine if DNSC could reconcile the differences and provide causes of the out-of-balance conditions. The DNSC systems personnel corrected 40 of these based on discrepancies they identified between DNSC and depot records. Included in the 40 imbalances corrected were results from the 1992 Fort Worth Zone Office reconciliation. Systems personnel stated they could have corrected the MIF in 1992 had they received the report. There were no systematic problems that could be identified on what caused the differences between the MIF and the Form 46 cards. Delays in processing OSRs and other documents was the largest single reason for the differences.

Accounting for Stockpile Materials Contracted for Sale and Shipped

Depot managers maintained and monitored the stockpile materials located at their respective depots. As part of their responsibility, they prepared and forwarded to DNSC all OSRs, indicating stockpile materials sold and shipped. The DNSC input each OSR into a computerized log and posted it to the MIF to reduce the on-hand inventory balance. The DNSC summarized the information each month and provided it to DFAS Columbus Center for updating the general ledger accounts. The general ledger accounts were the basis for DFAS Columbus Center preparing the monthly trial balance.

In September 1995, systems personnel did not post by the end FY 1995, 51 (35 percent) of the 147 OSRs received during the month. Systems personnel also had 8 (2 percent) of 448 OSRs from July and August 1995 that had not been processed. The audit did not review documents earlier than July due to the low error rate for July and August. Because the 59 OSRs reflected inventory reductions that were not posted to the MIF, the Stockpile Materials account balance shown on the FY 1995 financial statements was overstated by their value, \$41 million. Because the OSR processing procedures did not specify time requirements for posting OSRs, to include posting OSRs within the same accounting period received, or require that the monthly inventory summary reports include all OSRs received during a month, procedures to ensure that inventory transactions were reported in the proper period were insufficient.

Finding A. Accuracy of Financial Statements Stockpile Materials Account Balance

Accounting for Stockpile Materials Contracted for Sale But Not Shipped

In December 1994, the DNSC Office of Financial Management began using the "Inventory Sold Pending Shipment" account, as an inventory subaccount, to separate stockpile materials that were contracted for sale but not shipped from the remainder of the stockpile materials on-hand inventory. On the December 1994 inventory summary report, systems personnel began providing the account totals and transactions to DFAS Columbus Center accountants. Based on these inventory summary reports, the DFAS Columbus Center accountants posted transactions to this subaccount until May 1995. The DNSC Office of Financial Management, at that time, determined that 2 of the 6 journal entries posted during December 1994 through May 1995 were incorrect. Both errors occurred during months when a negative change to the account balance occurred. The May 1995 inventory summary report and attached memorandum instructed DFAS Columbus Center to transfer the current balance of \$78.6 million for the "Inventory Sold Pending Shipment" account back into the total on-hand inventory. The subaccount and any applicable journal entries were not to be used during the remainder of the fiscal year. However, the incorrect journal entries for \$12 million were not corrected until October 1995 and the corrections were not reflected in the FY 1995 financial statements issued in March 1996. The financial statements were not updated because DNSC, the preparer of the statements, used the September 1995 trial balance provided by DFAS Columbus Center as the basis for reporting account balances. The DFAS Columbus Center accountants stated that since the correction was made in October, the correction would be shown on the October trial balance, because their policy is not to update previous months' trial balances. Not updating the September trial balance should not have kept the DNSC financial statement preparers from correcting an account balance they knew was incorrect.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Administrator, Defense National Stockpile Center:

a. Reconcile the Master Inventory File and the Defense Logistics Agency Inventory Record Cards and correct discrepancies to ensure that the balance of stockpile materials reported on the FY 1996 financial statements and the stockpile material values shown on the Master Inventory File as available for sale are accurate.

Finding A. Accuracy of Financial Statements Stockpile Materials Account Balance

b. Improve procedures for accomplishing periodic reconciliations that would provide depot personnel periodic copies of the Master Inventory File, require periodic reconciliation of the Master Inventory File to the Defense Logistics Agency Inventory Record Cards, and provide results to the Defense National Stockpile Center Systems Support and Inventory Accountability Division for updating the Master Inventory File.

c. Develop procedures requiring the posting of all inventory transactions during the fiscal year in which the transactions occur.

Management Comments. Management concurred, stating the Defense National Stockpile Center (DNSC) will set up a Business Process Review team to determine how current procedures can be modified to improve existing reconciliation and inventory procedures. The team will address periodic reconciliation of the Master Inventory File (MIF) and DLA Inventory Record Cards, including how often the MIF should be provided to the depots and in what format. The team is expected to develop a plan of action and milestones by July 26, 1996. The plan will include procedures for posting inventory transactions during the fiscal year in which the transactions occur. At that time, DNSC will develop a final target completion date.

Audit Response. Management comments were responsive to the recommendations. However, we request a copy of the Business Process Review final plan for improving existing procedures.

A.2. We recommend that the Administrator, Defense National Stockpile Center, in coordination with the Director, Defense Finance and Accounting Service Columbus Center, implement procedures to ensure that all corrections made after the end-of-fiscal-year trial balance is prepared are included in the fiscal year financial statements affected by the corrections.

Management Comments. Management concurred, stating DNSC will work with DFAS to ensure that all corrections made after the end of the fiscal year are included in the appropriate financial statements. Although not required to comment, the Deputy Director for Accounting, DFAS stated that DFAS would work with DNSC to help develop procedures to ensure that timely corrections are included in the financial statements. Planned completion date is September 30, 1996.

Finding B. Collection Procedures

The DNSC did not effectively pursue the collection of \$13.4 million in delinquent accounts receivable and related interest charges. For example, \$4.5 million in accounts receivable have been delinquent since FYs 1991 through 1994, and \$1.2 million of interest charges are over 120 days old. Ineffective collections occurred because standard operating instructions did not exist for monitoring and collecting delinquent accounts receivable and related interest charges. Additionally, coordination and communication between the three DNSC offices involved in handling delinquent accounts receivable were inadequate. As a result, DNSC could not adequately identify and collect delinquent accounts receivable and related interest charges. Unless these problems are corrected, valid amounts due to the Federal Government will continue to go uncollected.

Accounts Receivable and Related Interest Charges

As of September 1995, DNSC had a total of \$13.4 million in accounts receivable and interest charges delinquent for at least 60 days. Specifically, the Accounts Receivable Age Report dated September 1995 showed DNSC had approximately \$12.2 million in accounts receivable delinquent for over 60 days. Of the \$12.2 million, \$5.3 million (43 percent) was delinquent for over 120 days, \$4.5 million of which has been delinquent since FYs 1991, 1993, and 1994. In addition, the September 1995 Interest Age Report showed that DNSC had approximately \$1.2 million in interest charges due for over 120 days.

Current DNSC Collection Procedures

Responsible Offices. The DFAS Columbus Center personnel provide the DNSC Office of Financial Management with monthly accounts receivable and interest age reports. Three offices within DNSC -- the Office of Financial Management (finance), the Directorate of Stockpile Contracts (contracting), and the Office of Counsel (legal) -- are responsible for the collection of delinquent accounts receivable and related interest charges.

Written Collection Procedures. The DNSC did not have written standard operating instructions for the collection of delinquent accounts receivable and interest charges. Contracting stated that contracting officers are required to follow the Federal Acquisition Regulation (FAR) and its Defense supplement

Finding B. Collection Procedures

for all contracting matters. Finance had written standard operating procedures effective December 1994 for the processing of delinquent bill letters (also known as demand letters). The procedures consisted of six steps that outlined the progression of responsibility from finance to contracting to legal for demand letter processing. However, the written procedures were not provided to contracting or legal for implementation.

These written procedures for processing demand letters were not comprehensive enough to address the three offices' collection procedures. Instead the procedures mainly outlined the steps for issuing demand letters, which are only part of the collection process. For example, the demand letter procedures did not specify the:

- o office with the final responsibility for determining whether a delinquent account receivable or related interest charge was uncollectible,
- o dollar threshold that DNSC used to determine whether it is cost beneficial to pursue the collection of an amount outstanding,
- o steps necessary to inform DNSC finance personnel or the accountants at the DFAS Columbus Center that an amount was determined to be uncollectible, or
- o procedures necessary for remanding delinquent accounts to DFAS Columbus Center Debt Management Division for collection.

Actual Collection Practices. The DNSC actual process for issuing demand letters differed from finance management's written procedures. The DNSC finance, contracting, and legal personnel gave varying descriptions of the DNSC actual collection practices concerning the:

- o total number of demand letters finance and contracting personnel process,
- o when the demand letters were to be issued,
- o the length of time allowed a contractor to respond to demand letters, and
- o the office or agency responsible for collecting delinquent accounts receivable or related interest charges after finance issued demand letters.

The varying descriptions confirmed the need for written procedures. Finally, according to contracting personnel, no delinquent amounts in FY 1995 had been referred to the DFAS Columbus Center Debt Management Division because all

amounts were considered collectible. See Part I.B. for a discussion explaining how the uncollectible accounts receivable policy does not comply with DoD established guidance.

Collection Process Coordination

The lack of coordination and communication between the three offices involved in the collection process caused unnecessary errors and delays in collecting debts. This is evident in the following examples.

- o When DNSC moved to Fort Belvoir, Virginia, in July 1995, finance provided a list of 35 contracts, which it had designated as closed, to the DFAS Columbus Center. However, according to the Accounts Receivable Age Report and the Interest Age Report, dated September 1995, approximately \$206,000, included in the \$13.4 million in delinquent accounts receivable and interest charges, was still outstanding on 21 (60 percent) of those contracts. The DNSC finance personnel erroneously categorized the 21 contracts as closed even though they did not know whether contracting officers or legal personnel were actively pursuing collections. Finance attributed the error to the general confusion that existed as a result of trying to get all the documents from one place to another. See Appendix D for listing of 21 contracts and the related amounts outstanding.

- o Listed on the FY 1995 yearend trial balance and financial statements was approximately \$120,600 in accounts receivable. According to the September 1995, Accounts Receivable Age Report, the \$120,600 accounts receivable was listed as being with DNSC legal for resolution. However, legal was not familiar with the contracts that made up this amount nor did they realize they were supposed to be pursuing the collection. Further research determined that the three contracts involved were actually referred to the General Services Administration Legal Counsel prior to 1988, when the General Services Administration still controlled the Stockpile. The accounts receivable were carried over when the Stockpile function was transferred from the General Services Administration to DoD in 1988, and 7 years later were still reflected in the financial statements. According to public law, the \$120,600 can no longer be pursued except in the case of an administrative offset. See Appendix C for a discussion on the public law and other regulatory guidance on accounts receivable and interest charges. See Appendix D for the listing of the three contracts and related amounts outstanding.

- o Finance acknowledged that when a DNSC contracting officer considered a contract closed, and decided that outstanding amounts were uncollectible, then stopped further collection procedures, contracting officers

Finding B. Collection Procedures

did not always inform DNSC finance or the accountants at the DFAS Columbus Center. Due to this lack of communication, the DFAS Columbus Center would continue to include the uncollectible accounts receivable on the Fund's trial balance, and DNSC would then report them as legitimate accounts receivable on the financial statements. The practice of reporting delinquent accounts receivable as valid DNSC assets on the financial statements, even though no further actions are being taken to pursue the collection, resulted in an inaccurate financial picture for DNSC operations.

Recommendations, Management Comments, and Audit Response

B. We recommend that the Administrator, Defense National Stockpile Center:

1. Research and actively pursue collection of the \$12.2 million in delinquent accounts receivable; \$1.2 million in delinquent interest charges; and for the approximately \$120,600 in accounts receivable delinquent since 1988, determine whether administrative offsets can be pursued or write-off the accounts.

Management Comments. Management concurred, stating DNSC is establishing a task force to review all delinquent accounts receivable. Any accounts receivable that cannot be collected or written off will be referred to DFAS for appropriate action. Planned completion date is September 30, 1996.

2. Establish written standard operating instruction for monitoring and collecting delinquent accounts receivable and interest charges that implement the requirements prescribed in the applicable regulations. These procedures should include requirements for documentation retention, a mechanism for tracking the status of collection actions, and communication of the uncollectible status of accounts receivable and interest charges to the Defense Finance and Accounting Service Columbus Center so that the accounts receivable can be written off and prevent the inaccurate reporting of assets.

Management Comments. Management concurred, stating DNSC has revised the delinquent bill letter to conform with the DoD Financial Management Regulation. DNSC will also develop standard operating procedures for monitoring and collecting delinquent accounts receivable and interest charges. Planned completion date is September 30, 1996.

3. Assign primary collection responsibility to one Defense National Stockpile Center office. The office should have designated officials responsible for administering the actions necessary to pursue the collection of delinquent accounts receivable and related interest charges. The responsible official should establish a control record for each contract debt as required by the Federal Acquisition Regulation.

Management Comments. Management concurred, stating DNSC has assigned primary responsibility for pursuit of collection of delinquent accounts receivables and related charges to the DNSC Office of Financial Management. A control record for each contract debt will be established. Planned completion date is September 30, 1996.

4. Forward all debts greater than \$600, not determined to be uncollectible, to the Defense Finance and Accounting Service Columbus Center Debt Management Division for collection.

Management Comments. Management concurred, stating in accordance with the DoD Financial Management Regulation, if no response is received to the second demand letter, DNSC will forward all debts greater than \$600, not deemed uncollectible, to DFAS. Management considers their actions complete.

Finding C. Interest Charges

The DFAS Columbus Center and DNSC did not record or report \$1.3 million in interest revenue due to the U.S. Treasury. Specifically, during FY 1995, the DFAS Columbus Center did not use standard general ledger accounts for recording interest charges billed and collected on delinquent accounts receivable and did not report the interest revenue due to the U.S. Treasury on the fiscal yearend trial balance. In addition, even though DNSC had the interest revenue information, they did not report it in the financial statements. Although DFAS Columbus Center accountants were computing the interest, they had not considered incorporating the standard general ledger accounts necessary to record the interest revenue due to the U.S. Treasury in the trial balance. DNSC management stated that the DFAS Columbus Center was responsible for billing interest charges on delinquent accounts receivable and recording the interest charges due to the U.S. Treasury on the trial balance, which DNSC then used to generate the financial statements. As a result, the Fund's FY 1995 financial statements understated by \$1.3 million debts owed to the Federal Government.

Recording Interest Charges

The DFAS Columbus Center was responsible for billing contractors interest charges on delinquent accounts receivable. In January 1995, DFAS Columbus Center developed interest-age reports and began using the report to monitor interest charges due on delinquent accounts receivable. According to DFAS Columbus Center management, before DFAS Columbus Center started this practice, interest charges were not monitored by DFAS or DNSC. Even though DFAS Columbus Center realized that interest charges billed but not collected were not receiving any visibility on the Fund trial balance, management believed it was important that the interest charges at least be monitored. Financial Management Regulation (FMR), volume 1, "General Financial Management Information, Systems, and Requirements," May 1993, and volume 4, "Accounting Policy and Procedures," January 1995, provide guidance on accounting for and reporting interest charges. See Appendix C for discussion on the FMR guidance pertaining to interest charges.

The DFAS Columbus Center generated the interest-age reports monthly. The report disclosed the amount of interest billed on a contract, the amount of interest collected, and the age of the interest charges. The DFAS Columbus Center provided a copy of this report to DNSC every month, in order for DNSC to pursue the collection of the interest charges billed.

The interest revenue due to the U.S. Treasury results from interest charges DFAS Columbus Center bills contractors for delinquent accounts receivable less the interest charges subsequently collected by DFAS Columbus Center and DNSC. According to the September 1995 Interest Age Report, at the end of FY 1995, \$1.8 million in interest charges had been billed on delinquent accounts receivable and approximately \$500,000 had been collected. However, because the DFAS Columbus Center did not incorporate standard general ledger accounts to record the interest charges billed and collected, the trial balance did not disclose the resulting \$1.3 million in interest revenue due to the U.S. Treasury.

Reporting Interest Charges

In the FY 1995 financial statements, DNSC did not report the \$1.3 million in interest charges due to the U.S. Treasury. During FY 1995, DNSC also did not report interest charges due to the U.S. Treasury in the Standard Form 220-9 "Report on Receivables Due from the Public." According to DNSC management, it is the responsibility of the DFAS Columbus Center to record and report the interest revenue due to the U.S. Treasury on the trial balance. The DNSC management explained that DNSC relied on the figures from the fiscal yearend trial balance in order to generate the financial statements. Therefore, it was a DFAS Columbus Center responsibility to inform DNSC of the interest charges due to the U.S. Treasury. However, DNSC management stated that future disclosure of the interest revenue due to the U.S. Treasury on the financial statements could be readily accomplished. Although we recognize the need to use the trial balance as the source for the financial statement, DNSC had the information and could have updated the financial statements to reflect the \$1.3 million increase in the amount due to the U.S. Treasury.

Recommendations, Management Comments, and Audit Response

C.1. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, establish accounts to record interest charges receivable and the interest revenue collected and deposited into a U.S. Treasury receipt account as required by the applicable regulations and include those amounts in the trial balance.

Management Comments. The Deputy Director for Accounting, Defense Finance and Accounting Service concurred, stating accounts will be established

Finding C. Interest Charges

to record interest charges receivable and interest collected and deposited into the U.S. Treasury receipt account on the trial balance used by DNSC for preparing the financial statements. Planned completion date is September 30, 1996.

C.2. We recommend that the Administrator, Defense National Stockpile Center:

a. **Disclose in the National Defense Stockpile Transaction Fund Financial Statements or Footnotes to those Principal Statements the total amount of interest revenue due to the U.S. Treasury and the amount of interest revenue collected during the fiscal year and deposited into the U.S. Treasury receipt account.**

b. **Report interest revenue due to the U.S. Treasury on the "Federal Agencies' Centralized Trial Balance System." This automated trial balance system replaces the Standard Form 220-9 "Report on Receivables Due from the Public" used in FY 1995.**

Management Comments. Management concurred, stating action will be taken for the FY 1996 reports and in conjunction with implementation of the Standard General Ledger. Planned completion date March 31, 1997.

Audit Response. Management actions were responsive to the intent of the recommendation. However, since financial statements are due to OMB by March 1, 1997, and the audit opinion for the financial statements must be issued by February 15, 1997, management must complete the action prior to February 1, 1997 for inclusion on the FY 1996 financial statements.

Part I.B. - Review of Compliance with Laws and Regulations

Introduction

We reviewed compliance with laws and regulations to obtain reasonable assurance that the financial statements were free of material misstatements and not to provide an opinion on overall compliance with such provisions. As part of obtaining reasonable assurance about whether the financial statements were free of material misstatements, we reviewed compliance with laws and regulations that directly affected the financial statements, and with certain other laws and regulations designated by the OMB and the DoD. Compliance with laws and regulations applicable to the Fund is the responsibility of Chief Financial Officer of the DoD; Director, DFAS; Director, DLA; Comptroller, DLA, and DNSC management. See Appendix E for applicable laws and regulations we reviewed.

Reportable Conditions

Material instances of noncompliance are failures to follow requirements, laws, or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures is either material to the financial statements, or the sensitivity of the matter would cause others to perceive it as significant. The results of our reviews indicate that management generally complied with the selected provision of laws and regulations as they pertain to the accuracy of the financial statements. The audit did not detect any material noncompliance issues. However, DNSC was not in compliance with guidance addressing recognizing revenue, using appropriate U.S. Treasury interest receivable accounts, using allowance for uncollectible accounts and uncollectible accounts written off. In addition, DNSC did not comply with guidance provided for the preparation of financial statements, accounting for prior period adjustments, and disclosing inventory in appropriate categories (Finding D).

Additional regulations that were not complied with, as they relate to the internal control weaknesses addressed in Part I.A. include: FAR 32.6, "Contract Debts," April 1, 1984; Defense FAR Supplement 232.6, "Contract Debts," 1991 edition; and DLA Manual 7000.1, "DLA Accounting and Finance Manual," August 1980. Compliance issues identified during our review would not have a material impact on the financial statements. With respect to the items not tested, nothing came to our attention that caused us to believe that the Fund managers had not complied, in all material respects, with those provisions identified above.

Revenue Recognition. The DNSC did not recognize revenue during the fiscal year in which it was earned and match the related expenses. Specifically, DFAS Columbus Center recognized revenue when the contract for sale of stockpile material had been awarded, instead of when payment was received. The DNSC finance personnel stated this method best represented the amount of work completed by DNSC as it applied to the sale. In addition, DNSC cited FMR, volume 4, chapter 18, "Revenues," January 1995, that states that revenues shall be recognized when they become realizable with reasonable practical certainty; that is, when the customer's accounting entity acknowledges a claim against its resources, or the performing accounting entity has an enforceable claim.

However, DNSC disposal contracts specified that delivery terms were free on board shipping point and that title to materials purchased passed to the purchaser when the materials were paid for. The DNSC prepared contracted materials for delivery and allowed the purchasers anywhere from 30 to 180 days to pay for and pick up the materials. Upon payment, DNSC authorized the responsible depot to release the materials. When the materials were picked up by a contractor, DNSC instructed the DFAS Columbus Center to debit the cost of goods sold account and reduce the on-hand inventory account balance by the amount picked up.

In addition, FMR, volume 4, chapter 16, "Revenues, Expenses, Gains, and Losses," January 1995, states that the basis for recording an amount as a revenue shall be the delivery of goods and services as evidenced by documentation of performance, a billing to the ordering activity, or the establishment of an accrual evidenced by constructive delivery or percentage of completion. Statement of Federal Financial Accounting Standards No. 3, states that Inventory shall be recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity. Upon sale (when the title passes or goods are delivered) or upon use in the provision of a service, the related expense shall be recognized and the cost of those goods shall be removed from inventory. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

Therefore, because the disposal contracts specified that title passage occurred when the purchaser paid for the materials, which normally occurred just prior to picking them up, these events should trigger revenue recognition and the removal of cost of goods sold from on-hand inventory. Moreover, the generally accepted accounting principle of matching revenues to expenses requires accounting records to display revenues and their related expenses within the same accounting period. The result of current DNSC accounting practice overstated Revenue from Disposal of Stockpile Materials and Net Position by posting revenues prior to their related expenses.

Review of Compliance With Laws and Regulations

Interest Charges. The DFAS Columbus Center and DNSC did not record or report \$1.3 million in interest revenue due to the U.S. Treasury. Therefore, DNSC and DFAS Columbus Center did not comply with FMR volumes 1 and 4. The noncompliance with the FMR and the facts relating to the DFAS and DNSC handling of interest charges is fully discussed in Part I.A., Finding C.

Allowance for Uncollectible Accounts. The DFAS Columbus Center had not been effectively using the allowance for uncollectible accounts. Even though the pre-closing trial balance reflected an allowance for uncollectible accounts balance, the balance was static throughout the fiscal year, and no support was provided to relate the balance to a current estimate of uncollectible accounts. For example, a \$100,000 unsupported entry that was transferred in 1988 from the General Services Administration has been reduced to \$34,000 with no support for the reduction or the remaining amount. DFAS Columbus Center and DNSC current procedures do not comply with FMR, volume 4, chapter 3, "Receivables," January 1995, that requires every DoD Component to ensure that their accounting systems provide for the establishment of allowances for uncollectible accounts.

Uncollectible Accounts Written Off. During FY 1995, DNSC had not written off any accounts receivable even though most of the \$5.3 million in accounts receivable due more than 120 days had been delinquent since FYs 1991 through 1994. These procedures do not comply with FMR, volume 4, chapter 1, "Financial Control of Assets," January 1995, that requires that losses on receivables should be recognized when it is likely that the receivable will not be collected. A detailed discussion on the \$5.3 million delinquent accounts receivable and other delinquent discrepancies can be found in Part I.A., Finding B.

Conclusion

Except for the recommendations made for the financial statement preparation finding that follows, we have not made recommendations in this section for each compliance issue. The DNSC and DFAS Columbus Center need to implement the regulations, standards, and generally accepted accounting principles addressed in Part I.A. and Part I.B. to resolve problems with revenue recognition, interest charges, allowance for uncollectibles, uncollectible write-offs, prior period adjustments, and disclosing inventory in the appropriate categories.

Finding D. FY 1995 Financial Statements Compliance with Form and Content

The DNSC did not accurately disclose the Fund's Net Position, prior period adjustments, and Stockpile Materials categories in the FY 1995 financial statements. These problems occurred due to a lack of formal training for the DNSC financial statement preparer and a lack of review by DNSC and DLA management. Another factor affecting the prior period adjustments was the reluctance at the DFAS Columbus Center to implement the Prior Period Adjustment account pending receipt of additional guidance regarding its use. As a result, the financial statements overstated Cumulative Results of Operations by \$124.7 million, understated Invested Capital by \$84.8 million and Unexpended Appropriations by \$40.1 million, overstated prior period adjustments by \$500,000, did not show the \$1.4 billion in congressionally authorized stockpile materials available for sale, and did not disclose \$108 million in stockpile materials that were contracted for sale but not shipped, including materials that had been on contract since FY 1992.

Financial Statement Disclosures

The Concept of Operations stated, although financial and general ledger accounting were to be performed by the DFAS Columbus Center, accounting reports for external submission were to be prepared by the DLA Central Accounts Office, renamed DLA Financial Policy, Systems and Control Office. The DLA office delegated the responsibility for preparing the FY 1995 Chief Financial Officer Annual Financial Statements to the DNSC. However, adequate training was not provided to the preparer or the reviewers.

Although "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity" does not provide exact formulas for calculating net position account balances, account descriptions and schedules are provided to facilitate calculations and presentation of balances. In addition, FMR volumes 1 and 4 provide guidance and require the use of prior period adjustment accounts.

Net Position. The reported Cumulative Results of Operations account balance as of September 30, 1995, did not include the net income for FY 1995. The calculation of the reported Invested Capital balance was not reconciled to related general ledger account balances and the calculation of Unexpended Appropriations did not follow the guidance schedule.

Finding D. FY 1995 Financial Statements Compliance with Form and Content

Prior Period Adjustments. Prior period adjustments were posted to the Retained Operating Results account in the general ledger, since the Prior Period Adjustments account was not used. The DFAS Columbus Center provided support for \$23.7 million in prior period adjustments in FY 1995, of which \$23.3 million resulted from defaulted contracts. The Statement of Operations (and Changes in Net Position) reported \$23.8 million in prior period adjustments as a result of defaulted contracts. Therefore, DNSC did not adequately reconcile prior period adjustments in calculating either the reported prior period adjustments balance, or the amount attributable to defaulted contracts.

Stockpile Materials. Because DNSC did not provide the DFAS Columbus Center with the balance of stockpile materials authorized for sale by Congress, DFAS Columbus Center did not include that figure in the general ledger or trial balance. The FMR volume 4, chapter 4, "Operating Materials and Supplies and Stockpile Materials," January 1995, states that stockpile materials should be classified in the trial balance as either Materials Held in Reserve or Materials Held for Sale. Once materials are authorized to be sold by Congress, the value of those commodities should be transferred to the Materials Held for Sale general ledger account and reported on the financial statements.

Recommendations, Management Comments, and Audit Response

D. We recommend that the Director, Defense Logistics Agency:

1. Train personnel in coordination with the Defense Finance and Accounting Service, on the preparation of the financial statements for the National Defense Stockpile Transaction Fund.

Management Comments. DLA management concurred and established an estimated completion date of September 30, 1996. Although not required to comment, DFAS management concurred, stating the Agency Reporting and Cash Reconciliation Division at the DFAS Columbus Center will provide assistance and guidance to DNSC personnel in preparing the financial statements. DFAS management agreed with the planned completion date of September 30, 1996.

2. Establish procedures to ensure that adequate reconciliations and reviews of the National Defense Stockpile Transaction Fund financial statements are performed prior to submission.

Management Comments. Management concurred and established an estimated completion date of January 31, 1997.

Part II - Additional Information

Appendix A. Audit Process

Scope

Statements Reviewed. We attempted to audit the FY 1995 Financial Statements for the National Defense Stockpile Transaction Fund (the Fund). The financial statements include the Statement of Financial Position and the Statement of Operations and Changes in Net Position. Also included are the Footnotes and the Overview to the Principal Statements. The financial statements upon which our opinion is based were dated December 26, 1995.

Auditing Standards. We conducted our audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD and OMB 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. We relied on the guidelines suggested by the General Accounting Office and our professional judgment in assessing the materiality of matters impacting the fair presentation of the financial statements and related internal control weaknesses.

Accounting Principles. Accounting principles and standards for the Federal Government remain under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the Director, OMB; the Secretary of the Treasury; and the Comptroller General, who are the principals of the Joint Financial Management Improvement Program (JFMIP). Specific standards agreed on by those three officials are issued by the Director, OMB, and the Comptroller General. To date, five accounting standards and two accounting concepts have been published in final form, and three accounting standards have been released in draft form.

Until all aspects of financial statement reporting are governed by accounting standards that will constitute "generally accepted accounting principles for the Federal Government," agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. The hierarchy constitutes an "other comprehensive basis of accounting" to be used for preparing Federal agencies' financial statements. A summary of the hierarchy defined and approved by the JFMIP Principals is as follows:

- o standards agreed to and published by the JFMIP Principals,
- o form and content requirements of the OMB,
- o accounting standards contained in agency guidance on accounting policies, and

- o accounting principles published by other authoritative sources.

Because only five accounting standards and two accounting concepts have been published by the JFMIP Principals, most accounting standards for the DoD "other comprehensive basis of accounting" are contained in DoD accounting policy guidance. Previously, DoD Manual 7220.9-M, the "DoD Accounting Manual," was the primary DoD accounting guidance. Since FY 1992, the Under Secretary of Defense (Comptroller) has updated sections of the "DoD Accounting Manual," and has incorporated those sections into new volumes of the FMR. The Under Secretary of Defense (Comptroller) plans to replace all sections of the "DoD Accounting Manual" with the FMR. The regulation, once completed, will serve as the single DoD-wide financial management regulation for use by all DoD Components for accounting, budgeting, finance, and financial management education and training.

OMB Statements of Federal Financial Accounting Standards and Concepts

<u>Number</u>	<u>Title</u>	<u>Status</u>	<u>Date</u>
Standard No. 1	Accounting for Selected Assets and Liabilities	Final	March 30, 1993
Standard No. 2	Accounting for Direct Loans and Loan Guarantees	Final	August 23, 1993
Standard No. 3	Accounting for Inventory and Related Property	Final	October 27, 1993
Standard No. 4	Managerial Cost Accounting Concepts and Standards for the Federal Government	Final	July 31, 1995
Standard No. 5	Accounting for Liabilities of the Federal Government	Final	September 1995
Concept No. 1	Objectives of Federal Financial Reporting	Final	September 2, 1993
Concept No. 2	Entity and Display	Final	June 6, 1995
TBD	Accounting for Property, Plant, and Equipment	Draft	February 28, 1995
TBD	Accounting for Revenue and Other Financing Sources	Draft	July 1995
TBD	Supplementary Stewardship Reporting	Draft	August 1995

Appendix A. Audit Process

Scope of Review of Internal Controls. Our consideration of the internal control structure included obtaining an understanding of significant internal control structure policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances. For those significant control policies and procedures that had been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed. For areas where internal controls were determined to be weak, we attempted to perform tests to determine the level of assurance that could be placed on those controls.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions, and would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

Scope of Review of Compliance with Laws and Regulations. As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatements, we reviewed compliance with laws and regulations that may directly affect the financial statements and other laws and regulations designated by the OMB and the DoD. See Appendix E for a complete list of laws and regulations we reviewed.

Time Period and Locations. We conducted this audit from July 1995 through April 1996 at the DNSC and its storage locations and at the Defense Finance and Accounting Service Columbus Center. Part II, Appendix G lists the organizations we visited or contacted.

Computer-Processed Data. To achieve the overall audit objective, we initially relied upon computer-processed data obtained from the DNSC MIF. We assessed the reliability of the MIF data by reviewing the general controls at DNSC, by comparing the MIF records to local site records, and by testing inventories of the stockpile materials. To perform the inventory of stockpile materials, we used both statistical and judgment samples. At audit inventory locations, comparisons were made among our physical inventory results, MIF information, and local records. The information provided by the MIF was found to be generally reliable and the discrepancies identified were not material to the financial statements.

Statistical Sampling Methodology

The Quantitative Methods Division, Inspector General, DoD, developed the statistical sampling plan for this audit. Their work included statistically selecting the locations and the inventory line items at each location. In addition, assistance was provided by the Army Corps of Engineers with regard to the measurement of sample selections of materials in bulk storage, as these materials were not readily countable.

Audit Universe. The audit universe consisted of all stockpile materials that were included in the inventory as of September 30, 1995. The reported value of the ending inventory shown on the FY 1995 financial statements was \$3,937,343,170. The sample selections were chosen from the MIF data base as of June 30, 1995, consisting of 36,274 records or line items representing commodities in 85 DNSC stockpile materials storage locations.

Sampling Plan. A multistage cluster random sample was employed for this audit. Factors in the sample selection process were: (1) the estimated auditing (travel) costs, (2) the relative values as reflected in the MIF of all of the inventory materials located within geographic clusters, and (3) the relative values of specific materials within a given cluster. The sample was selected to minimize the dollar values in factor 1, and to maximize the dollar values in factors 2 and 3. Asbestos, a hazardous material, was the only item excluded from possible sample selection. The sample selection consisted of 825 line items from 18 DNSC storage locations.

Judgment Sample. At each site chosen through statistical sampling, a judgment sample selection was made from the inventory of site materials after excluding statistical sample selections. Inventory results from the judgment sample were compared to local records and to the MIF records.

Sample Results. The inventory of sample selections was conducted from July through December of 1995. Although we were unable to verify the acquisition costs of stockpile materials, and therefore unable to make statistical projections regarding the overall inventory value, we were able to determine that on-hand quantities were generally accurate.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of the DNSC management controls as they relate to the Fund's financial statements. Specifically, we reviewed DNSC management controls over recording, accounting, and reporting financial information resulting from DNSC operations during FY 1995. Because we did not identify a material weakness as they relate to the financial statements, we did not assess management's self-evaluation.

Adequacy of Management Controls. The DNSC management controls we reviewed were adequate; we identified no material management control weaknesses as they relate to the financial statements. Even though DNSC had no material control weaknesses, audit suggestions implemented during audit fieldwork significantly strengthened the execution of the DNSC management control program.

Appendix B. Prior Audits and Other Reviews

During the last 5 years, the following reports relating to the Fund's financial statements and DNSC accounting policies and practices were issued:

General Accounting Office Report No. AIMD-95-35R (OSD Case 9842), "Stockpile Fund," December 16, 1994, states that the audit reviewed accounting policies and practices involved with cash and noncash transactions. The report states that cash and noncash transactions were not separately identified in the Fund's FY 1993 financial statements and annual Strategic and Critical Materials Report to the Congress for FY 1993. Also, the Fund's FY 1993 financial statements did not separately disclose all of the amounts comprising the Fund's net position, as prescribed by OMB. Additionally, the report states DNSC was not in compliance with Section 518 of Public Law 100-440, because the Fund used part of the estimated \$215.8 million appropriated to the Fund before January 1, 1985, on contracts involving in-kind exchanges, which did not meet the requirements of Section 518. The Fund was required to use all funds authorized and appropriated to evaluate, test, relocate, upgrade, or purchase stockpile materials, before January 1, 1988.

Inspector General, DoD Report No. 93-139, "National Defense Stockpile Transaction Fund Financial Statements for FY 1992," June 30, 1993, states that the Inspector General, DoD, issued a Disclaimer of Opinion on the financial statements because the DLA could not provide documentation to support the inventory valued on the financial statements and management did not provide the necessary management and legal representation letters. The audit did not disclose any reportable or material internal control weaknesses. The report states that the DNSC complied in all material respects with policies, laws, and regulations. The report did not contain any recommendations. However, management concurred with all of the facts presented in the audit report.

Inspector General, DoD Report No. 92-141, "National Defense Stockpile Transaction Fund," September 30, 1992, states that the financial status of the Fund as reported to Congress for FYs 1989 and 1990 was inaccurate. However, the audit identified no material internal control weaknesses related to procedures for reporting the financial status of the Fund to Congress. The audit recommended revising the reporting format for the Strategic and Critical Materials Report to Congress, correcting the balances reported to Congress for FYs 1989 and 1990, and establishing procedures for preparing the Strategic and Critical Materials Report to Congress that use accounting system data reported in the Report on Budget Execution. Management concurred with these recommendations and took corrective actions to revise the reporting format and reporting procedures in conformance with the audit recommendations.

Appendix C. Accounts Receivable and Interest Charges Criteria

Accounts Receivable Criteria

FAR 32.6, "Contract Debts," April 1984, prescribes policies and procedures for the Government's actions in ascertaining and collecting contract debts, charging interest on the debts, deferring collection, and compromising and terminating certain debts. Specifically, sections 2 through 16 provide procedures for assigning responsible officials to follow up on amounts due the Federal Government, debt determination, collection procedures to include documentation retention requirements, and compromise actions for debts less than \$100,000 that are deemed uncollectible. According to the FAR, the primary responsible official is the contracting officer or other official designated under agency procedures to administer the collection of contract debts and applicable interest.

Defense FAR Supplement 232.6, "Contract Debts," 1991, provides additional guidance for debt determination and collection when the functions are performed by the disbursing officers, in coordination with the contract finance office and the contracting officer.

DLA Manual 7000.1, "DLA Accounting and Finance Manual," chapter 12, "Debt Claims," August 1980, provides guidance for the processing of debt claims of the United States which arise as a result of operations of, or are referred to, the DLA. The regulation requires that claims against business entities will be ascertained and documented promptly, and settlement or collection action will be initiated immediately and pursued aggressively until disposition. The guidance also includes procedures for handling claims which cannot be resolved through collection or setoff. This regulation was incorporated into the FMR volume 10, "Contract Payment Policy and Procedures, February 1996.

Title 28, United States Code, section 2415, "Time for Commencing Action," and title 31, United States Code, section 3716, "Administrative Offset," advise that because of the statute of limitations, agencies are barred from pursuing collection actions after six years other than administrative offsets. An offset can be made up to 10 years.

Appendix C. Accounts Receivable and Interest Charges Criteria

Interest Charges Criteria

FMR, volume 4, "Accounting Policy and Procedures," chapter 1, "Financial Control of Assets," January 1995, provides guidance for the reporting of receivables that are not due to the collecting entity. This regulation states that receivables should be distinguished between entity receivables and non-entity receivables. Non-entity receivables are amounts that the entity collects on behalf of the U.S. Government or other entities, and the entity is not authorized to spend. Receivables not available to an entity should be reported separately from receivables available to the entity.

FMR, volume 4, chapter 3, "Receivables," January 1995, provides specific guidance on the accounting for interest charges. This regulation states that accounting for receivables shall include provisions for accruing interest on delinquent accounts from the public in accordance with title 31, United States Code, section 3717. Additionally, this regulation requires accounting systems to be designed to accumulate and record such charges for all debts owed the U.S. Government.

FMR, volume 1, "General Financial Management Information, Systems, and Requirements," chapter 7, "DoD Standard General Ledger," May 1993, provides the standard general ledger accounts that can be used for recording amounts owed to the U.S. Treasury. This regulation indicates that there are two authorized General Fund Receipts accounts. These two accounts are Uncollected Revenue-General Fund-Miscellaneous Receipts, account 3610, and Funds Returned to General Fund-Miscellaneous Receipts, account 3620. Account 3610 represents the uncollected amount of receivables due to be returned to the U.S. Treasury-Miscellaneous Receipts. Account 3620 represents the funds returned and deposited to the General Fund-Miscellaneous Receipts account.

Appendix D. Accounts Receivable on Closed Contracts

21 Closed Contracts with Outstanding Accounts Receivable as of September 30, 1995

<u>Contract Number</u>	<u>Principal Due</u>	<u>Interest Due</u>	<u>Total</u>
11084	\$1,040.00	\$0.00	\$1,040.00
11099	160.00	0.00	160.00
11106	480.00	0.00	480.00
11100	360.00	0.00	360.00
11114	510.00	0.00	510.00
11120	1,376.00	0.00	1,376.00
11126	560.00	0.00	560.00
21014	168,190.00	0.00	168,190.00
21029	244.00	0.00	244.00
21038	160.00	0.00	160.00
21040	250.00	0.00	250.00
21044	120.00	0.00	120.00
21056	320.00	0.00	320.00
21112	40.00	0.00	40.00
21113	80.00	0.00	80.00
24040	3,885.00	0.00	3,885.00
24041	2,815.91	0.00	2,815.91
24042	150.00	0.00	150.00
24024	16,523.96	2,590.46	19,114.42
24047	525.00	4,496.64	5,021.64
24066	1,365.30	124.22	1,489.52
Totals	\$199,155.17	\$7,211.32	\$206,366.49

3 Contracts Categorized as Accounts Receivable Other-Non Current as of September 30, 1995

<u>Contract Number</u>	<u>Commodity</u>	<u>Amount Due</u>
23304	Manganese	\$26,540.98
23304	Manganese	41,874.24
93008	Rare Earth	51,143.75
93079	Rare Earth	1,056.00
Total		\$120,614.97

Appendix E. Laws and Regulations

Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982," September 8, 1982

Public Law 97-365, "Debt Collection Act of 1982," October 25, 1982

Public Law 100-496, "Prompt Payment Act of 1988," October 17, 1988

Public Law 101-576, "Chief Financial Officers Act of 1990," November 15, 1990

Public Law 103-335, "DoD Appropriations Act for FY 1995," September 30, 1994

Public Law 103-337, "National Defense Authorization Act for 1995," October 5, 1994

Title 28, U.S.C., section 2415, "Time for Commencing Action"

Title 31, U.S.C., section 3716, "Administrative Offset"

OMB Circular No. A-127, "Financial Management Systems," December 19, 1984

OMB Circular No. A-123 Revised, "Internal Control Systems," June 21, 1995

OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993

OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993

OMB Statements of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," October 27, 1993

FAR 32.6, "Contract Debts," April 1, 1984

"DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," October 20, 1994 (additional guidance provided on January 20, 1995)

Appendix E. Laws and Regulations

DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983

DoD 7000.14-R, "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993

DoD 7000.14-R, "DoD Financial Management Regulation," volume 4, "Accounting Policy and Procedures," January 1995

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987

Defense FAR Supplement 232.6, "Contract Debts," 1991 edition

DLA Manual 7000.1, "DLA Accounting and Finance Manual," August 1980

**Appendix F. Financial Statements and Auditor
Opinion**

*National Defense Stockpile
Transaction Fund*

**Chief Financial
Officer
Annual Financial
Statement
FY 1995**

March 1, 1996

NATIONAL STOCKPILE TRANSACTION FUND

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Overview

***NATIONAL STOCKPILE
TRANSACTION FUND***

OVERVIEW

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Overview

Overview

**DEFENSE NATIONAL STOCKPILE TRANSACTION FUND
FY 95 OVERVIEW**

The mission of the Defense National Stockpile Center (DNSC) is to administer the acquisition, storage, management, and disposal of the nation's strategic and critical inventory of material essential to the Military and industrial requirements of the United States.

The National Defense Stockpile Transaction Fund (T-Fund) is a revolving fund that accounts for resources necessary to procure and dispose strategic commodities. These financial statements only reflect this accounting entity (the T-Fund).

These financial statements have been prepared to report on the financial position and the results of operations of the DLA T-Fund, pursuant to the requirements of the Chief Financial Officers Act of 1990. While the financial statements have been prepared from the books and records of T-Fund in accordance with the formats prescribed by the Office of Management and Budget (OMB), these statements are different from the financial reports and statements (that are also prepared from the same books and records) used to monitor and control budgetary resources.

The National Defense Stockpile Transaction Fund was established by the Strategic and Critical Materials Stock Piling Act (50 USC 98) of 1979. At that time, all existing Government-owned raw material was transferred to and capitalized in the National Defense Stockpile Transaction Fund. The fund can receive appropriations and can retain proceeds from disposal of excess material(s). These receipts are to be used for the acquisition of new or additional material requirements as defined in the Defense Requirements Report to Congress. In addition, as permitted and encouraged by the Act, acquisition of stockpile material can be accomplished by barter and through exchanges. Public Law 100-180 and Executive Order 12626 authorized the transfer of the management of the Stockpile from the General Services Administration and the Federal Emergency Management Administration to the Department of Defense effective July 3, 1988. Within the Department of Defense, management of the Stockpile was assigned to the Defense Logistics Agency, Defense National Stockpile Center.

Stockpile material is stored at numerous locations throughout the United States: in Department of Defense, other government agencies, and public storage facilities. The DNSC, located in the Headquarters Complex, Fort Belvoir, Virginia centrally administers the acquisition, storage, management, and disposal of the Nation's inventory of strategic requirements of the United States.

Public Law 102-484 authorized the DNSC's levels of acquisitions and disposals for FY 1995. In FY 95 Congress legislated \$54.2 million for the operation and acquisition programs. The DNSC obligated \$38.4 million for Operation and Maintenance and \$4.4 million for the

Appendix F. Financial Statements and Auditor Opinion

Overview

acquisition of strategic and critical materials, mobilization studies, and service contracts in accordance with the Congressionally approved Annual Material Plan (AMP).

In FY 95 Congress also authorized \$572.7 million of material to be disposed. The DNSC disposed of \$427.6 million of excess materials. The material disposed of was legislatively detailed in the FY 95 Defense Authorization Bill and in accordance with the Congressionally approved AMP.

Financial Performance

The following definitions of the financial performance measures stem from DoD guidance. We have provided them here to clarify the graphs on the following page.

Definitions:

Net Operating Costs - The total expenses minus the total revenue.

Current Ratio - An indicator of financial condition, it is calculated by dividing current assets by current liabilities.

Operating Results - The total revenues minus the total expenses.

Financial Obligations - The total of current and long-term liabilities.

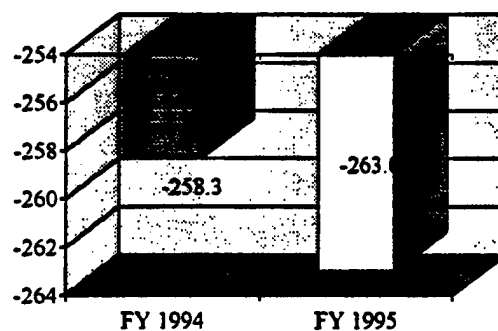
Ending Fund Balance - The Fund balance with the Treasury.

The Net Operating Cost in FY 95 was -\$262,960,467 compared to -\$258,342,737 for FY 94. Conversely, the Operating Result was \$262,960,467 for FY 95 compared to \$258,342,737 for FY 94. One reason for the positive operating results for the last two years is that the current world situation has reduced the threat of global conventional war. Specifically, some inventory levels were determined to be higher than the foreseeable requirements and are being reduced, thus increasing revenue. It should be noted that all revenue and expenses are not necessarily cash transactions because revenues are often realized and expenditures were often made through barter transactions including exchange of material and payment-in-kind.

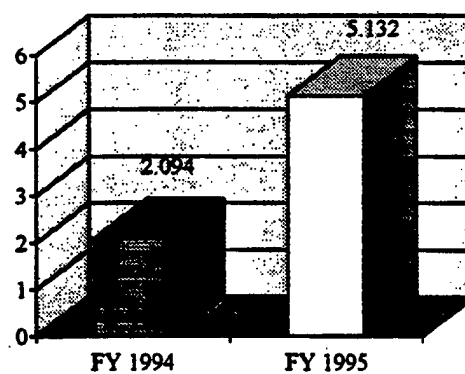
The Current Ratio was 5.1324 for FY 95 compared to 2.094 in FY 94. The Financial Obligations (current and long-term liabilities) were \$77,417,813 for FY 95 compared to \$97,301,998 in FY 94. The Ending Fund Balance was \$168,613,356 in FY 95 compared to \$55,591,433 in FY 94.

Overview

NET OPERATING COSTS
TOTAL EXPENSES - TOTAL REVENUE
In Millions of Dollars



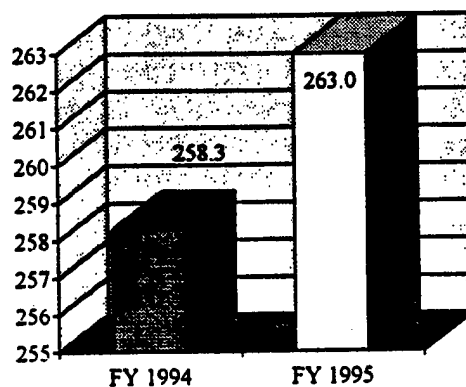
CURRENT RATIO
CURRENT ASSETS/CURRENT LIABILITIES
In Millions of Dollars



Overview

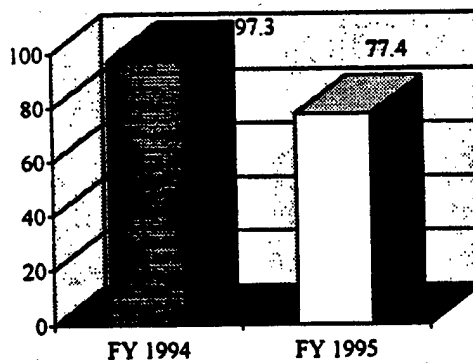
OPERATING RESULTS
TOTAL REVENUE - TOTAL EXPENSES

In Millions of Dollars



FINANCIAL OBLIGATIONS
CURRENT & LONG-TERM LIABILITIES

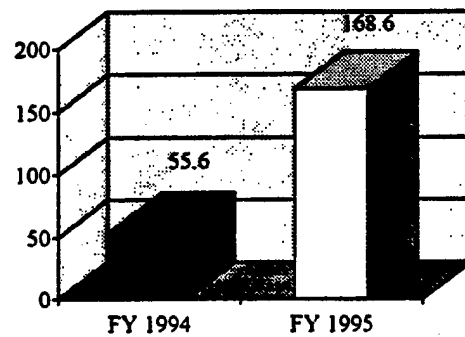
In Millions of Dollars



Overview

ENDING FUND BALANCE

In Millions of Dollars



Appendix F. Financial Statements and Auditor Opinion

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Principal Statements

***NATIONAL STOCKPILE
TRANSACTION FUND***

PRINCIPAL STATEMENTS

Appendix F. Financial Statements and Auditor Opinion

Principal Statements

Appendix F. Financial Statements and Auditor Opinion

Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Financial Position
as of September 30, 1995
(Thousands)

ASSETS	1995	1994
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1). Fund Balances with Treasury (Note 2)	\$168,613	\$55,589
(a) Funds Collected	316,307	336,765
(b) Funds Disbursed	(203,283)	(462,965)
(c) Funds with Treasury	\$55,589	181,789
(2). Investments, Net (Note 4)	0	0
(3). Accounts Receivable, Net (Note 5)	5,816	1,697
(4). Interest Receivable	0	0
(5). Advances and Prepayments	13,473	11,671
(6). Other Federal (Intragovernmental) (Note 6)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1). Investments (Note 4)	0	0
(2). Accounts Receivable, Net (Note 5)	222,864	146,439
(3). Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	0
(4). Interest Receivable, Net	0	0
(5). Advances and Prepayments	0	0
(6). Other Non-Federal (Governmental) (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	0	0
e. Work in Process (Note 9)	0	0
f. Operating Materials/Supplies, Net (Note 10)	0	0
g. Stockpile Materials, Net (Note 11)	3,937,343	4,063,479
h. Seized Property (Note 12)	0	0
i. Forfeited Property, Net (Note 13)	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	0
k. Property, Plant and Equipment, Net (Note 15)	0	0
l. Other Entity Asset	0	0
m. Total Entity Assets	<u>\$4,348,109</u>	<u>\$4,278,875</u>
2. Non-Entity Assets:		
a. Transactions With Federal (Intragovernmental) Entities:		
(1). Fund Balance with Treasury (Note 2)	0	0
(2). Accounts Receivable, Net (Note 5)	0	0
(3). Interest Receivable, Net	0	0
(4). Other (Note 6)	0	0

The accompanying notes are an integral part of these statements.

Appendix F. Financial Statements and Auditor Opinion

Principal Statements

Department of Defense
 Defense National Stockpile Transaction Fund
 Statement of Financial Position
 as of September 30, 1995
 (Thousands)

Assets Continued	1995	1994
2 Non-Entity Assets Continued:		
b. Transactions With Non-Federal (Governmental) Entities:	0	0
(1). Accounts Receivable, Net (Note 5)	0	0
(2). Interest Receivable, Net	0	0
(3). Other	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Other Non-Entity Assets	0	0
e. Total Non-Entity Assets	<u>\$0</u>	<u>\$0</u>
3. Total Assets	<u>\$4,348,109</u>	<u>\$4,278,875</u>
LIABILITIES		
4 Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:	\$73,801	\$83,434
(1). Accounts Payable	0	0
(2). Interest Payable	0	0
(3). Debt (Note 16)	0	0
(4). Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:	3,086	7,059
(1). Accounts Payable	0	0
(2). Accrued Payroll and Benefits	0	0
(a). Salaries and Wages	0	0
(b). Annual Accrued Leave	0	0
(c). Severance Pay and Separation Allowance	0	0
(3). Interest Payable	0	0
(4). Liabilities for Loan Guarantees (Note 7)	0	0
(5). Lease Liabilities (Note 18)	0	0
(6). Pensions and Other Actuarial Liabilities (Note 19)	0	0
(7). Other Non-Federal (Governmental) Liabilities (Note 17)	531	6,809
c. Total Liabilities Covered by Budgetary Resources:	<u>\$77,418</u>	<u>\$97,302</u>

The accompanying notes are an integral part of these statements.

Appendix F. Financial Statements and Auditor Opinion

Principal Statements

Department of Defense
 Defense National Stockpile Transaction Fund
 Statement of Financial Position
 as of September 30, 1995
 (Thousands)

	1995	1994
Liabilities Continued		
5. Liabilities not Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1). Accounts Payable		
(2). Debt (Note 16)		
(3). Other Federal (Intragovernmental) Liabilities (Note 17)		
b. Transactions with Non-Federal (Governmental) Entities:		
(1). Accounts Payable		
(2). Debt (Note 16)		
(3). Lease Liabilities (Note 18)		
(4). Pensions and Other Actuarial Liabilities (Note 19)		
(5). Other Non-Federal (Governmental) Liabilities (Note 17)		
c. Total Liabilities not covered by Budgetary Resources	<u>\$0</u>	<u>\$0</u>
6. Total Liabilities	<u>\$77,418</u>	<u>\$97,302</u>
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	\$347,710	\$98,191
b. Invested Capital	3,602,186	\$3,837,001
c. Cumulative Results of Operations	320,795	246,383
d. Other		
e. Future Funding Requirements		
f. Total Net Position	<u>\$4,270,691</u>	<u>\$4,181,575</u>
8. Total Liabilities and Net Position	<u>\$4,348,109</u>	<u>\$4,278,877</u>

The accompanying notes are an integral part of these statements.

Appendix F. Financial Statements and Auditor Opinion

Principal Statements

Department of Defense
 Defense National Stockpile Transaction Fund
 Statement of Operations (and Changes in Net Position)
 For Period Ended September 30, 1994
 (Thousands)

	1995	1994
REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used		
2. Revenues from Sales of Goods and Services	420,314	443,016
a. To the Public	43,145	32,262
b. Intragovernmental	0	0
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	3,591	218
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies		
8. Total Revenues and Financing Sources	<u>\$467,050</u>	<u>\$475,496</u>
EXPENSES		
9. Program or Operating Expenses (Note 23)	52,753	58,897
10. Cost of Goods Sold (Note 24)		
a. To the Public	141,979	150,984
b. Intragovernmental	9,632	8,132
11. Depreciation and Amortization	0	0
12. Bad Debts and Write-offs	(254)	(860)
13. Interest	0	0
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	0	0
14. Other Expenses (Note 25)	0	0
15. Total Expenses	<u>\$204,110</u>	<u>\$217,153</u>
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	\$262,940	\$258,343
17. Plus (Minus) Extraordinary Items (Note 26)		
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	<u>\$262,940</u>	<u>\$258,343</u>

The accompanying notes are an integral part of these statements.

Appendix F. Financial Statements and Auditor Opinion

Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Operations (and Changes in Net Position)
For Period Ended September 30, 1994
(Thousands)

EXPENSES Continued	1995	1994
19. Net Position, Beginning Balance, as Previously Stated	\$4,181,565	\$4,325,174
20. Adjustments (Note 27)	<u>(23,814)</u>	
21. Net Position, Beginning Balance, as Restated	\$4,157,751	\$4,325,174
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	\$262,940	\$258,343
23. Plus (Minus) Non Operating Changes (Note 28)	<u>(\$150,000)</u>	<u>(\$401,952)</u>
24. Net Position, Ending Balance	<u>\$4,270,691</u>	<u>\$4,181,565</u>

The accompanying notes are an integral part of these statements.

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Appendix F. Financial Statements and Auditor Opinion

Principal Statements

The accompanying notes are an integral part of these statements.

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***NATIONAL STOCKPILE
TRANSACTION FUND***

***FOOTNOTES
TO THE
PRINCIPAL STATEMENTS***

Appendix F. Financial Statements and Auditor Opinion

Footnotes

Appendix F. Financial Statements and Auditor Opinion

Footnotes

Note 1. Summary Of Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Defense Logistics Agency (DLA) National Defense Stockpile Transaction Fund, (the T-Fund) as required by the Chief Financial Officers (CFO) Act of 1990. They have been prepared from the accounting records of the Fund in accordance with the hierarchy of accounting standards as prescribed by the Federal Accounting Standards Advisory Board (FASAB), OMB Bulletin 94-01 and supplemental DoD guidance. The accounting standards prescribed by the FASAB, in the DoD Accounting Manual (DoD 7220.9-M) and in the Financial Management Regulation (DoD 7000.14-R) were followed, as appropriate. To the extent that guidance is not provided by one of these standards, the T-Fund accounts for transactions in accordance with guidance promulgated by the GAO, OMB, Department of Treasury, and commercial Generally Accepted Accounting Principles. These statements differ from the T-Fund financial reports prepared to monitor and control the use of budgetary resources. Amounts presented in the financial statements and footnotes are rounded to the nearest thousand dollars unless otherwise indicated.

B. Reporting Entity

The Defense Logistics Agency (DLA) is a combat support agency responsible for worldwide logistics support throughout the Department of Defense. The primary focus of DLA is to provide logistics support the war fighter. In addition, DLA provides support to relief efforts during times of national emergency. The DLA Defense National Stockpile Center (DNSC) administers the acquisition, storage, management, and disposal of the nation's strategic and critical inventory of materials essential to the Military and industrial requirements of the United States. The T-Fund is a revolving fund that accounts for resources necessary to procure and dispose strategic commodities. The appropriation symbol is 97X4555.5145.

The CFO Act requires the T-Fund as a revolving fund to provide audited financial statements. FY 95 represents the fourth year that the T-Fund has prepared financial statements as required by the CFO Act.

C. Budgets and Budgetary Accounting

The T-Fund receives an apportionment from the Office of Management and Budget for the operation and acquisition programs.

D. Basis of Accounting

Transactions are recorded on an accrual basis and on a budgetary basis. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when

Appendix F. Financial Statements and Auditor Opinion

Footnotes

incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

E. Revenues and Other Financing Sources

Revenues and financing sources for the T-Fund consists of cash proceeds from the disposal of excess commodities and exchanges of commodities for the payment of obligations.

F. Accounting for Intragovernmental Activities

DLA, as an agency of the Federal government, interacts with, and is dependent upon, other financial activities of the government as a whole. As a result, these financial statements do not reflect the results of all financial decisions applicable to DLA as though the agency were a stand alone entity.

For example, DLA's proportionate share of the public debt and related expenses of the Federal Government are not included in these financial statements because debt and related interest costs are not apportioned to Federal agencies.

Also, financing for the construction of DoD facilities is obtained through appropriations from the Congress. To the extent that this financing may have been ultimately obtained through the issuance of public debt, interest costs have not been capitalized since the Treasury Department does not allocate interest costs to the benefiting agencies.

Finally, the T-Fund's civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS). The T-Fund does not disclose the assets or actuarial data on the accumulated plan benefits or unfunded pension liabilities of its employees. Reporting such amounts is the responsibility of the Office of Personnel Management for CSRS and FERS.

G. Funds with the U.S. Treasury and Cash

The funds with the U.S. Treasury represent the balances as of 30 September 1995. The buying and disposal of commodities affect the available balances.

I. Accounts Receivable

Allowances for uncollectible accounts are established. Sales and disposals are billed after the sales agreement is made or as of the scheduled time of delivery or pickup of the material. When material is disposed through the exchange program, billings are credited when the exchange is completed. Storage charges are assessed and billed if the purchaser does not pickup the material within the agreed upon time frame.

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Footnotes

K. Inventories

The financial inventory balance for the stockpile materials is maintained on a laid in cost basis, that is, acquisition cost plus any fees, such as testing, upgrading, and transportation expenses. It is reported as Stockpile materials.

When the mission of the Stockpile was transferred to the DoD from GSA in 1988, the DoD IG audited the physical inventory records and historical values of the inventory were established. The establishment of historical costs was necessary at that time because the original records of some of the purchases dated back to the 1950's and were no longer available. The market value of the material as of 30 September 1995 is estimated to be in excess of \$6 billion.

M. Property, Plant and Equipment

Currently National Stockpile Transaction Fund does not track equipment or depreciation expenses. Data is being gathered to be included in FY 96 statements.

N. Prepaid and Deferred Charges

Payments before the receipt of goods and services are recorded as advances at the time of prepayment. Expenses are recognized when the related goods and services are received.

O. Leases

The T-Fund is committed to operating leases and rental agreements. Generally, these leases and agreements are for the rental of equipment, space and operating facilities. Payments under these operating leases are expensed as incurred.

P. Contingencies

The T-Fund may be party to various legal and administrative claims and actions. In management's opinion, the resolution of these actions will not materially affect the T-Fund operations or financial position. Therefore, no contingent liabilities have been recognized in the Statement of Financial Position.

Q. Accrued Leave

Civilian annual leave is accrued as earned, and accrued hours are reduced as leave is taken. Sick leave and other types of nonvested leave are expensed as taken.

R. Equity

Equity consists of unexpended appropriations, invested capital, cumulative results of operations, and other equity balances.

Appendix F. Financial Statements and Auditor Opinion

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U. Comparative Data

The financial statements present FY 94 and FY 95 amounts. For FY 94, the financial statements were not audited. As a result, management cautions financial statement users regarding FY 94 amounts.

V. Restatement of Prior Year Principal Statements

The Statement of Financial Position and Statement of Operations and Changes in Financial Position for FY 94 have been restated to permit the preparation of comparative statements due to significant changes in reporting requirements required by the OMB.

W. Unpaid Obligations and Undelivered Orders

The T-Fund is obligated for goods and services that have been ordered but not yet received. Total undelivered orders amounted to \$ 40,086,438 as of September 30, 1995

X. Non Cash (Barter) Transactions

Line 1.a.(1).a, Funds Collected, includes \$30,870,684 in non cash collections
Line 1.a.(1).b, Funds Disbursed, includes \$30,870,684 in non cash disbursements
Line 1.b.(2) includes \$4,331,911 in non cash accounts receivable
Line 4.b.(1) includes \$3,085,984 in non cash accounts payable
Line 7.b includes \$27,476,846 in net non cash sales

Note 2. Fund Balances With Treasury

A. Business Operations Fund (USD(C)) and All Other Funds and Accounts

	<u>Entity Assets (In Thousands)</u>
Unobligated Balance Available	
Available	\$347,756
Restricted	(179,143)
Reserve for Anticipated Resources	0
Obligated (but not expensed)	0
Unfunded Contract Authority	0
Unused Borrowing Authority	0
Total	<u>\$168,613</u>

Appendix F. Financial Statements and Auditor Opinion

Footnotes

B. Business Operations Fund Activities Below USD(C) Level:

	<u>In Thousands</u>	
	<u>Funds Collected</u>	<u>Funds Disbursed</u>
Beginning Balance:		
Transfers of non-cash to Others	\$55,589	\$150,000
Transfers of non-cash from Others		
Funds Collected	347,178	
Funds Disbursed		84,154
Ending Balance	<u>\$402,767</u>	<u>\$234,154</u>

C. **Other Information:** Funds Collected includes \$30,870,684 in non cash (barter) collections and Funds Disbursed includes an equal amount in non cash (barter) disbursements for a net of \$0.

Note 5. Accounts Receivable, Net

	(1)	(2)	(3)	(4)
	<u>Gross</u>	<u>Allowance for</u>	<u>Allowance</u>	<u>Net</u>
	<u>Amount Due</u>	<u>Estimated</u>	<u>Method Used</u>	<u>Amount Used</u>
		<u>Uncollectibles</u>		
A. Entity Receivables:				
Intragovernmental	\$5,816	0	NA	\$5,816
Governmental	\$222,864	0	NA	\$222,864
B. Non-Entity Receivables:				
Intragovernmental	0	0	NA	0
Governmental	0	0	NA	0

C. **Other Information:** Governmental Receivables include \$4,332 thousand in non-cash sale contracts issued as exchange/payment-in-kind payments against prior year acquisition contracts.

Appendix F. Financial Statements and Auditor Opinion

Footnotes

Note 11. Stockpile Materials

		<u>In Thousands</u>			<u>Valuation Method</u>
		<u>Stockpile Materials Amount</u>	<u>Allowance for Losses</u>	<u>Stockpile Materials, Net</u>	
A.	Stockpile Materials:				
(1)	Held for Sale	\$0	\$0	\$0	
(2)	Held in reserve for future Sale	<u>3,937,343</u>	<u>0</u>	<u>3,937,343</u>	Historical Cost
	Total	<u>\$3,937,343</u>	<u>\$0</u>	<u>\$3,937,343</u>	

B. Restrictions on stockpile materials and supplies: There are several restrictions on the use of the material. The quantities to be stockpiled are required to be sufficient to sustain the U. S. for a period of not less than three years during a national emergency (including a sustained conventional global war of indefinite duration). The required stockpile levels can only be changed by law through a Presidential proposal in the annual material plan submitted to the Congress.

Except for disposals made under the following situations, disposals cannot be made from the stockpile:

- Necessary upgrading, refining or processing
- Necessary rotation to prevent deterioration
- Determination as excess and of potential financial loss if not disposed
- By order of the President and/or authorized by law

C. Other Information: The estimated market value of the total inventory as of 30 September 1995 is in excess of \$6 billion. The financial statements report the recorded historical cost in accordance with the lower of cost or market principal.

Note 15. Property, Plant And Equipment, Net

Currently National Stockpile Transaction Fund does not track equipment or depreciation expenses. Data is being gathered to be included in FY 96 statements.

Appendix F. Financial Statements and Auditor Opinion

Footnotes

Note 17. Other Liabilities

<u>In Thousands</u>			
A. Other Liabilities Covered by Budgetary Resources:			
	Non-Current Liability	Current Liability	Total
1. Intragovernmental			
(1) None	\$ 0	\$ 0	\$ 0
Total	\$ 0	\$ 0	\$ 0
2. Governmental			
(1) Bid Deposits	\$ 0	\$ 531	\$ 531
Total	\$ 0	\$ 531	\$ 531

Note 20. Net Position

	<u>In Thousands</u>
A. Unexpended Appropriations:	
(1) Unobligated, Available	168,614
(2) Undelivered Orders	179,096
B. Invested Capital	3,602,186
C. Cumulative Results of Operations	320,795
D. Future Funding Requirements	0
E. Other	
F. Total	<u>\$4,270,691</u>

G. Other Information: FY 94 and FY 95 invested capital balances include the following amounts for unobligated appropriations and cash and noncash undelivered orders.

	FY 95	FY 94
Unobligated Appropriations	\$379.4 Million	\$155.9 Million
Cash and Non-Cash Undelivered Orders	<u>47.9 Million</u>	<u>96.7 Million</u>
Overstatement of Net Position	<u>\$427.3 Million</u>	<u>\$252.6 Million</u>

Note 22. Other Revenue And Financing Sources

	<u>In Thousands</u>	
	1995	1994
A. Other Revenues and Financing Sources		
(1) Refunds from Contractors	\$ 198	\$ 33
(2) Storage Charges	247	185
(3) Administrative Charges	3,146	0
Total	<u>\$ 3,591</u>	<u>\$ 218</u>

Appendix F. Financial Statements and Auditor Opinion

Footnotes

Note 23. Program Or Operating Expenses

		<u>In Thousands</u>	
A. Operating Expenses by Object Classification:		1995	1994
(1)	Personal Services and Benefits	\$13,436	\$13,932
(2)	Travel and Transportation	1,096	1,227
(3)	Rental, Communications and Utilities	12,803	18,256
(4)	Printing and Reproduction	6	13
(5)	Contractual Services	6,096	12,955
(6)	Supplies and Equipment	1,142	861
(7)	Equipment not Capitalized	162	0
(8)	Grants, Subsidies and Contributions	18,011	11,053
(9)	Insurance Claims and Indemnities	0	0
(10)	Other		
	(a) County Taxes	1	0
(11)	Total Expenses by Object Class	<u>\$52,753</u>	<u>\$ 58,897</u>

Note 24. Cost of Goods Sold

A. Cost of Material Sold from Inventory		<u>In Thousands</u>
	Beginning Inventory:	\$4,063,479
	Plus: Purchases at Cost	24,967
	Plus: Inventory Gains	540
	Less: Inventory Losses	286
	Less: Ending Inventory	<u>3,937,343</u>
	Cost of Goods Sold:	<u>* \$151,357</u>

* The Cost of Goods Sold of \$151,357 thousand has included Line No. 12 (Bad Debts and Write-offs) of \$(254) thousand, which represents a net inventory gain of \$(254) thousand.

Note 27. Prior Period Adjustments

This represents amount of defaulted contracts.

Appendix F. Financial Statements and Auditor Opinion

Footnotes

Note 28. Non-Operating Changes

	<u>In Thousands</u>
A. Decreases:	
(1) U.S. Army	\$50,000
(2) U.S. Air Force	50,000
(3) U.S. Navy	<u>50,000</u>
(4) Total Decrease	<u>\$150,000</u>
B. Net Non Operating Changes (Transfers)	<u>\$150,000</u>
C. Other Information: The decreases are transfers to the Services O&M accounts per Congressional directive. The "Other" decrease consists of adjustments to prior year sales.	

Footnotes 3, 4, 6, 7, 8, 9, 10, 12, 13, 14, 16, 18, 19, 21, 25, 26, and 29 are not applicable to the Certified Financial Statements for National Stockpile Transaction Fund.

Appendix F. Financial Statements and Auditor Opinion

Footnotes

Audit Opinion

***NATIONAL STOCKPILE
TRANSACTION FUND***

AUDIT OPINION

Appendix F. Financial Statements and Auditor Opinion

Audit Opinion _____

Appendix F. Financial Statements and Auditor Opinion

Audit Opinion



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2804



February 29, 1996

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Disclaimer of Opinion on the National Defense Stockpile Transaction Fund
Financial Statements for FY 1995 (Project No. 5FH-2022)

Introduction

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by statutory Inspectors General. The CFO Act prescribes the responsibility of management and auditors with respect to the financial statements, internal controls, and compliance with laws and regulations. Fund managers are responsible for establishing and maintaining an internal control structure and complying with laws and regulations applicable to the National Defense Stockpile Transaction Fund (the Fund). Our responsibility is to express an opinion on the financial statements based on our audit and determine whether internal controls are adequate and whether the Fund complied with applicable laws and regulations.

Disclaimer of Opinion

We were not able to audit the financial statements because the reported value of the inventory, approximately 91 percent of the total assets, could not be substantiated. The unsubstantiated value occurred because the Defense National Stockpile Center could not provide supporting documentation for the inventory purchased prior to 1988. The pre-1988 assets represent the bulk of the inventory value shown on the financial statements. The supporting documents were not received from the General Services Administration when the assets were transferred to DoD in 1988. Discussions with General Services Administration personnel revealed that many of the inventory commodities were purchased in the 1940's and 1950's and no documents were available. Therefore, we could not verify the acquisition cost related to the inventory account and must provide a disclaimer of opinion. We were able to determine that the on-hand quantities recorded on depot records were accurate.

Our review provided a reasonable basis to determine the adequacy of the internal control structure and compliance with laws and regulations as they relate to the financial statements of the Fund. Our review would not necessarily disclose all internal control and compliance reportable conditions that might also

Audit Opinion

be considered material weaknesses. Reportable internal control and compliance conditions are summarized in this report and will be further addressed in our internal control and compliance report to be published at a later date.

Internal Controls

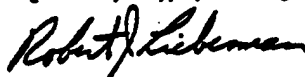
We reviewed the internal control structure of the Fund and obtained an understanding of the internal control policies and procedures. In addition, we reviewed the implementation of the Management Control Program by the Fund managers. We performed applicable tests of the internal control structure to determine whether the controls were effective and working as designed.

The internal control structure was effective in accounting for and managing resources, ensuring compliance with laws and regulations, and ensuring that the financial statements are free of material misstatements. However, management needs to improve the internal controls relating to collecting and reporting accounts receivable and interest due to U.S. Treasury, classifying inventory assets, reconciling the Master Inventory File Listing maintained at Defense National Stockpile Center headquarters to on-site records, using the general ledger accounts, reconciling the financial statements to the trial balance, and establishing and implementing the Management Control Program.

The Defense National Stockpile Center's and the Defense Finance and Accounting Service Center, Columbus (DFAS-CO) Stock Fund Section's Annual Statements of Assurance did not identify any material weaknesses as related to the Fund's activities. None of the accounts affected by internal control weaknesses or noncompliance with laws and regulations that we tested resulted in a material misstatement on the financial statements. DFAS-CO identified some of these same conditions in their draft management control review.

Compliance With Laws and Regulations

We reviewed compliance with selected provisions of laws and regulations as they pertain to the accuracy of the financial statements. Management generally complied with the provisions. Compliance issues identified during our review would not have a material impact on the financial statements. These issues pertain to the noncompliance with guidance set forth in the DoD Financial Management Regulation, such as, using appropriate U.S. Treasury interest receivable accounts and showing inventory in appropriate categories.



Robert J. Lieberman
Assistant Inspector General
for Auditing

Appendix G. Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Under Secretary of Defense (Comptroller), Washington, DC

Department of the Army

U.S. Army Corps of Engineers Waterways Experiment Station, Vicksburg, MS
Binghamton Army Depot, Binghamton, NY
Blue Grass Army Depot, Richmond, KY
Ravenna Army Ammunition Plant, Ravenna, OH
Sierra Army Depot, Herlong, CA

Department of the Air Force

National Guard Bureau, Washington, DC

Other Defense Organizations

Defense Finance Accounting Service, Arlington, VA
Defense Finance and Accounting Service Center, Columbus, OH
Defense Logistics Agency, Fort Belvoir, VA
Defense National Stockpile Center, Fort Belvoir, VA
Defense National Stockpile Center, Zone 1, New York, NY
Defense National Stockpile Center, Zone 2, Hammond, IN
Defense National Stockpile Center, Zone 3, Fort Worth, TX
Curtis Bay Depot, Baltimore, MD
Hammond Depot, Hammond, IN
New Haven Depot, Fort Wayne, IN
Scotia Depot, Scotia, NY
Somerville Depot, Somerville, NJ
Stockton Depot, Stockton, CA
Topeka Depot, Topeka, KS
Voorheesville Depot, Voorheesville, NY
Warren Depot, Warren, OH
Defense Construction Supply Center, Columbus, OH

Non-Defense Federal Organizations

U.S. Mint, West Point, NY
U.S. Assay Office, San Francisco, CA
U.S. Bullion Depository, Fort Knox, KY

Non-Government Activity

National Refractory and Minerals Corporation, Moss Landing, CA

Appendix H. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller) and Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Logistics Agency
Administrator, Defense National Stockpile Center
Director, National Security Agency
Inspector General, National Security Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
National Security and International Affairs Division, Technical Information Center,
U.S. General Accounting Office

Chairman and ranking minority member of each of the following congressional
committees and subcommittees:

Senate Committee on Appropriations
 Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
 House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
 House Subcommittee on National Security, International Affairs, and Criminal
 Justice, Committee on Government
 Reform and Oversight
House Committee on National Security

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Part III - Management Comments

Under Secretary of Defense Comptroller Comments



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



JUN 17 1996

MEMORANDUM FOR ACTING DIRECTOR, FINANCE AND ACCOUNTING
DIRECTORATE, INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Draft Audit Report on Internal Controls and Compliance with Laws and Regulations
for the National Defense Stockpile Transaction Fund Financial Statements for FY
1995 (Project No. 5FH-2022.01)

This memorandum is in response to your memorandum of May 24, 1996, requesting comments from this office on the subject draft audit report. The Defense Finance and Accounting Service and the Defense Logistics Agency will respond directly concerning the recommendations addressed to those organizations.

While the disclaimer of opinion letter that the DoDIG provided for inclusion with the financial statements identifies the reason for the disclaimer of opinion on the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, that reason is not stated or addressed in the subject report. The report simply references the Financial Statements which are to be included as Appendix F in the report. The casual reader of the audit report could easily come away confused as to why the disclaimer was issued and attribute the disclaimer to the conditions identified in the report. This office strongly recommends that the wording in the "Disclaimer of Opinion" paragraphs of the draft report's Executive Summary and Part I be revised to clearly identify that the lack of documentation to support the inventory valuation is the reason for the disclaimer. In addition, the reader should be informed that a tentative agreement on the valuation issue has been reached between the Office of Management and Budget, the General Accounting Office, the DoDIG and this office that will preclude a disclaimer on future financial statements for the National Defense Stockpile Transaction Fund.

This office appreciates the opportunity to comment on the subject draft report. The staff point of contact for this matter is Mr. Henry Bezold. He may be reached by phone at (703) 614-3523 or via email (bezoldh@smtpsu.ousdc.osd.mil).


Alvin Tucker
Deputy Chief Financial Officer

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

JUN 24 1996

DFAS-HQ/AFB

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Preparation of response to DoD IG Draft Report,
"Internal Controls and Compliance with Laws and
Regulations for the National Defense Stockpile
Transaction Fund Financial Statements for
FY 1995," (Project No. SFH-2022.01)

We have reviewed the subject draft report and are
providing the attached management comments. Any questions
may be directed to Mr. Charles McIntosh on (703) 607-5105.

A handwritten signature in dark ink, appearing to read "T. McCarty".

Thomas F. McCarty
Deputy Director for
Accounting

Attachment

Defense Finance and Accounting Service Comments

RECOMMENDATION A2: We recommend that the Administrator, Defense National Stockpile Center (DNSC), in coordination with the Director, Defense Finance and Accounting Service - Columbus Center (DFAS-CO), implement procedures to ensure that all corrections made after the end-of-fiscal-year trial balance is prepared, are included in the fiscal year financial statements affected by the corrections.

Management Comments: Concur. The Financial Statements are prepared by DNSC. We concur that procedures are necessary to assure that all corrections made after the end-of-fiscal-year trial balance is prepared, are included in the fiscal year financial statements. DFAS-CO provided end-of-fiscal-year 1995 trial balance corrections to DNSC in a timely manner. Pen and ink changes for the corrections should have been made by DNSC to the trial balance for the affected General Ledger Accounts and the correct amounts included in the financial statements and properly explained in the footnotes. We will work with DNSC to help develop procedures to ensure that timely corrections are included in the financial statements. Estimated completion date is September 30, 1996.

RECOMMENDATION C1: We recommend that the Director, DFAS-CO, establish accounts to record interest charges receivable and the interest collected and deposited into a U.S. Treasury receipt account as required by the applicable regulations and include those amounts in the trial balance.

Management Comments: Concur. The Stockpile Transaction Fund Financial Statements should reflect interest receivables as non-entity assets as required by the Chief Financial Officers Act, DoD Guidance on Form and Content of Financial Statements. We will establish the recommended accounts. In addition, DFAS-CO will continue to collect and provide interest receivable data to DNSC on the interest-age reports. We will also work with the DNSC staff to ensure that amounts are received. DNSC is responsible for CFO financial statements reporting for the Stockpile Transaction Fund and including the interest receivable in the financial statements based upon trial balances provided by DFAS-CO.

In addition, we will work with DNSC staff to collect and provide the interest receivable data. Reporting on the Report on Receivables Due From the Public (Receivables Report) and inclusion in the Federal Agencies' Centralized Trial-balance System reporting to the Department of the Treasury are the responsibility of DNSC. Estimated completion date is September 30, 1996.

Defense Finance and Accounting Service Comments

RECOMMENDATION D1: We recommend that the Director, Defense Logistics Agency, train personnel in coordination with the DFAS-HQ, on the preparation of the financial statements for the National Defense Stockpile Transaction Fund.

Management Comments: Concur. We agree that training in this area would be beneficial. The Agency Reporting and Cash Reconciliation Division staff at DFAS-CO will provide assistance and guidance to DNSC personnel in preparing the financial statements. Estimated completion date is September 30, 1996.

Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

IN REPLY
REFER TO

DDAI

LAUN 19 ESC

**MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITS
DEPARTMENT OF DEFENSE**

SUBJECT: Internal Controls and Compliance with Laws and Regulations for the National
Defense Stockpile Transaction Fund Financial Statements for FY 1995
(Project No. 5FH-2022.01)

This is in response to the May 24, 1996 Draft Report. If you have any questions, please
contact Mr. Dave Stumpf, (703) 767-6266.

Encl

FOR 
JACQUELINE G. BRYANT
Chief, Internal Review Office

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995 5FH-2022.01

FINDING A: The Stockpile Materials account balance shown on the FY 1995 financial statements was overstated by \$29 million. Specifically, the Master Inventory File (MIF), which supported the inventory balances reported in the financial statements, did not accurately show on-hand quantities, 59 Outboard Storage Reports (OSRs) were not posted to the MIF, overstating the account balance by \$41 million, and stockpile materials sold but not shipped were inaccurately accounted for, understating the account balance by \$12 million. These conditions occurred because DNSC did not have effective procedures for reconciling the MIF with the on-site records, and MIF data was not regularly available to depot personnel. In addition, management had not established a cut-off date for processing all OSRs prior to the end of the fiscal year and a lack of coordination existed between the DNSC and the DFAS Columbus Center when corrections were made after the fiscal year end. Without effective reconciliation procedures, the Stockpile Materials account could become misstated by a material amount in future years and decisions could be made to sell materials based on inaccurate data.

DLA COMMENTS: Concur.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:

Concur, however weakness is not considered material.

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
J.D. McCarthy, 17 Jan 96

DLA APPROVAL:

Ray E. McCoy
Ray E. McCoy
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, SFH-2022.01

RECOMMENDATION A.1: Recommend that the Administrator, Defense National Stockpile Center:

a. Reconcile the Master Inventory File and the Defense Logistics Agency Inventory Record Cards and correct discrepancies to ensure that the balance of stockpile materials reported on the FY 1996 financial statements and the stockpile material values shown on the Master Inventory File as available for sale are accurate.

b. Improve procedures for accomplishing periodic reconciliations that would provide depot personnel periodic copies of the Master Inventory File, require periodic reconciliation of the Master Inventory File to the Defense Logistics Agency Inventory Record Cards, and provide results to the Defense National Stockpile Center Systems Support and Inventory Accountability Division for updating the Master Inventory File.

c. Develop procedures requiring the posting of all inventory transactions during the fiscal year in which the transactions occur.

DLA COMMENTS:

Concur. DNSC will set up a Business Process Review team to determine how current procedures can be modified to improve existing reconciliation and inventory procedures. The team will address periodic reconciliation of the Master Inventory File (MIF) and DLA Inventory Record Cards, including how often the MIF should be provided to the depots and in what format. The team will develop a plan of action and milestones by July 26, 1996. The plan will include procedures for posting inventory transactions during the fiscal year in which the transactions occur. At that time, DNSC will develop a final target completion date.

DISPOSITION: Action is Ongoing. ECD: To be determined

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
J.D. McCarthy, 17 June 96

DLA APPROVAL:

[Signature]
RAY E. MCCOY
Major General, USA
Vice and Deputy, Director

Defense Logistics Agency Comments

Subject: Internal Controls and Compliance with Law and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 95, 5FH-2022.01

Recommendation No. A.2: We recommend that the Administrator, Defense National Stockpile Center, in coordination with the Director, Defense Finance and Accounting Service Columbus Center, implement procedures to ensure that all corrections made after the end-of-fiscal-year trial balance is prepared are included in the fiscal year financial statements affected by the corrections.

DLA Comments: Concur. DNSC will work with DFAS to ensure that all corrections made after the end of the fiscal year are included in the appropriate financial statements.

Disposition: Action is considered complete.

Action Officer: Simone Reba, DNSC-DF, 767-5524

Review/Approval: Richard J. Connelly, Administrator Defense National Stockpile Center

Coordination: *[Signature]*, DDAJ, 18 June 96

DLA Approval:

[Signature]
Ray E. McCoy
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, SFH-2022.01

FINDING B: Collection Procedures. The DNSC did not effectively pursue the collection of \$13.4 million in delinquent accounts receivable and related interest charges. For example, \$4.5 million in accounts receivable have been delinquent since Fys 1991 through 1994 and \$1.2 million of interest charges are over 120 days old. Ineffective collections occurred because standard operating instructions did not exist for monitoring and collecting delinquent accounts receivable and related interest charges. Additionally, coordination and communication between the three DNSC offices involved in handling delinquent accounts receivable were inadequate. As a result, DNSC could not adequately identify and collect delinquent accounts receivable and related interest charges. Unless these problems are corrected, valid amounts due to the Federal Government will continue to go uncollected.

DLA COMMENTS: Concur.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:

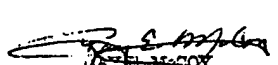
Concur, however weakness is not considered material.

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

J.D. McCarthy, 17 Jan 96

DLA APPROVAL:


J.D. McCarthy
Major General, USA
Principal Deputy Director

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, SFH-2022.01

RECOMMENDATION B.1: Recommend that the Administrator, Defense National Stockpile Center, research and actively pursue collection of the \$12.2 million in delinquent accounts receivable; \$1.2 million in delinquent interest charges; and for the approximately \$120,600 in accounts receivable delinquent since 1988, determine whether administrative offsets can be pursued or write-off the accounts.

DLA COMMENTS:

Concur. DNSC is establishing a task force to review all delinquent accounts receivable. Any accounts receivable that cannot be collected or written off will be referred to DFAS for appropriate action.

DISPOSITION:

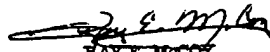
Action is Ongoing. ECD: 30 Sept 96

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

J.D. McCarthy, 17 Jan 96

DLA APPROVAL:


RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995; 5FH-2022.01

RECOMMENDATION B.2: Recommend that the Administrator, Defense National Stockpile Center, establish written standard operating instruction for monitoring and collecting delinquent accounts receivable and interest charges that implement the requirements prescribed in the applicable regulations. These procedures should include requirements for documentation retention, a mechanism for tracking the status of collection actions, and communication of the uncollectible status of accounts receivable and interest charges to the Defense Finance and Accounting Service Columbus Center so that the accounts receivable can be written off and prevent the inaccurate reporting of assets.

DLA COMMENTS:

Concur. DNSC has revised the delinquent bill letter to conform with the DoD Financial Management Regulation. DNSC will also develop detailed standard operating procedures for monitoring and collecting delinquent accounts receivable and interest charges.

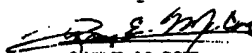
DISPOSITION: Action is Ongoing. ECD: 30 Sept 96

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

J.D. McCarthy, 11/2/95

DLA APPROVAL:



RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, SFH-2022.01

RECOMMENDATION B.3: Recommend that the Administrator, Defense National Stockpile Center, assign primary collection responsibility to one Defense National Stockpile Center office. The office should have designated officials responsible for administering the actions necessary to pursue the collection of delinquent accounts receivable and related interest charges. The responsible official should establish a control record for each contract debt as required by the Federal Acquisition Regulation.

DLA COMMENTS:

Concur. DNSC has assigned primary responsibility for pursuit of collection of delinquent accounts receivables and related charges to the DNSC Office of Financial Management, DNSC-DF. A control record for each contract debt will be established.

DISPOSITION:

Action is Ongoing. ECD: 30 Sept 96

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

J.D. McCarthy, 11 Jan 96

DLA APPROVAL:

Ray E. McCoy
RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, SFH-2022.01

RECOMMENDATION B.4: Recommend that the Administrator, Defense National Stockpile Center, forward all debts greater than \$600, not determined to be uncollectible, to the Defense Finance and Accounting Service Columbus Center Debt Management Division for collection.

DLA COMMENTS:

Concur. In accordance with the DoD Financial Management Regulation, if no response is received to the second demand letter, DNSC will forward all debts greater than \$600, not deemed uncollectible, to DFAS.

DISPOSITION:

Action is Considered Complete.

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
JDM, DDAS, 11 9 95

DLA APPROVAL:

[Signature]
Major General, USA
Principal Deputy Director

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, SFH-2022.01

FINDING C: Interest Charges. The DFAS Columbus Center and DNSC did not record or report \$1.3 million in interest revenue due to the U.S. Treasury. Specifically, during FY 1995, the DFAS Columbus Center did not use standard general ledger accounts for recording interest charges billed and collected on delinquent accounts receivable and did not report the interest revenue due to the U.S. Treasury on the fiscal year end trial balance. In addition, even though DNSC had the interest revenue information, they did not report it in the financial statements. Although DFAS Columbus Center accounts were computing the interest, they had not considered incorporating the standard general ledger accounts necessary to record the interest revenue due to the U.S. Treasury in the trial balance. DNSC management stated that the DFAS Columbus Center was responsible for billing interest charges on delinquent accounts receivable and recording the interest charges due to the U.S. Treasury on the trial balance, which DNSC then used to generate the financial statements. As a result, the Fund's FY 1995 financial statements understated by \$1.3 million debts owed to the Federal Government.

DLA COMMENTS: Concur.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:


Concur, however weakness is not considered material

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

JDM, DDAJ, 17 Jan 96

DLA APPROVAL:


MAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, 5FH-2022.01

RECOMMENDATION C.2: Recommend that the Administrator, Defense National Stockpile Center:

a. Disclose in the National Defense Stockpile Transaction Fund Financial Statements or Footnotes to those Principal Statements the total amount of interest revenue due to the U.S. Treasury and the amount of interest revenue collected during the fiscal year and deposited into the U.S. Treasury receipt account.

b. Report interest revenue due to the U.S. Treasury on the "Federal Agencies' Centralized Trial Balance System". This automated trial balance system replaces the Standard Form 220-9 "Report on Receivables Due from the Public" used in FY 1995.

DLA COMMENTS:

Concur. Action will be taken for the FY 1996 reports and in conjunction with implementation of the Standard General Ledger.

DISPOSITION:

Action is Ongoing. ECD: 31 Mar 97

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

J.D. McCarthy, 17 9-96

DLA APPROVAL:

[Signature]
RAY E. MCCOY
Major General, USA
Principal Deputy Director

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, SFH-2022.01

FINDING D: FY 1995 Financial Statements Compliance with Form and Content. The DNSC did not accurately disclose the Fund's Net Position, prior period adjustments, and Stockpile Materials categories in the FY 1995 financial statements. These problems occurred due to a lack of formal training for the DNSC financial statement preparer and a lack of review by DNSC and DLA management. Another factor affecting the prior period adjustments was the reluctance at the DFAS Columbus Center to implement the Prior Period Adjustment account pending receipt of additional guidance regarding its use. As a result, the financial statements overstated Cumulative Results of the Operations by \$124.7 million, understated Invested Capital by \$84.8 million and Unexpended Appropriations by \$40.1 million, overstated prior period adjustments by \$500,000, DoD not show the \$1.4 billion in congressionally authorized stockpile materials that were contracted for sale, but not shipped, including materials that had been on contract since FY 1992.

DLA COMMENTS:
Concur.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
Concur, however weakness is not considered material.

ACTION OFFICER: Richard Sninsky, FOX
PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
J.D. McCarthy, 17 Dec 96

DLA APPROVAL:

[Signature]
RICHARD SNINSKY
Director, Financial Management
Defense Logistics Agency

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, 5FH-2022.01

RECOMMENDATION D.1: Recommend that the Director, Defense Logistics Agency, train personnel in coordination with the Defense Finance and Accounting Service, on the preparation of the financial statements for the National Defense Stockpile Transaction Fund.

DLA COMMENTS: Concur.

DISPOSITION:

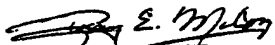
Action is Ongoing. Estimated completion Date: 30 Sept 96

ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

J.D. McCarthy, 17 Sept 96

DLA APPROVAL:


RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995, 5FH-2022.01

RECOMMENDATION D.2: Recommend that the Director, Defense Logistics Agency, establish procedures to ensure that adequate reconciliations and reviews of the National Defense Stockpile Transaction Fund financial statements are performed prior to submission.

DLA COMMENTS: Concur.

DISPOSITION:
Action is Ongoing. ECD: 31 Jan 97

ACTION OFFICER: Richard Sninsky, FOX
PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
J.D. McCarthy, 11 Jan 96

DLA APPROVAL:

[Signature]
BAY E. MURPHY
Major General, USA
Principal Deputy Director

AUDIT TEAM MEMBERS

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

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